The Final Nail in the Coffin for Mutual Funds

The mutual fund industry has been facing headwinds for years. First, the industry became too big. So dominant were the biggest funds, they couldn’t invest without moving the market themselves.

The next problem for mutual funds was the advent of the ETF. ETFs hollowed out the high-fee actively managed equity fund industry.

I wrote about these problems here in November of 2006:

> *I write often that the majority of mutual funds offer no compelling reason for investment. Here’s a double shocker for you. Of the top-ten largest equity mutual funds, seven come from one family. How could one management company capture so many places in the top-ten-size race? Must have pretty spectacular performance, right? That must be the reason. Well, performance has been fine, but the single compelling reason these funds sit at the top ten in size is that all seven have 5.75% front-end sales loads. Sales pressure gets big results. The majority of fund sales for load funds are made by salesmen to unsophisticated investors. No knowledgeable investor would invest in a load fund.*
>
> *The second big surprise is that I now think ETFs have come closer to being in a position to overwhelm the mutual fund industry. For the ETF industry as a whole, it is a little early in the game because, as yet, not all the chairs at the table have been filled. The fixed-income side needs to broaden out a lot. I especially hope that Vanguard will substantially broaden its ETF menu. I would guess that within a year I will be able to give the green flag to the ETF industry as the lead*

horse in the long-term race between ETFs and the mutual fund industry. There will be a select group of mutual fund groups that will continue to prosper as the ETF industry hollows out the mutual fund industry.

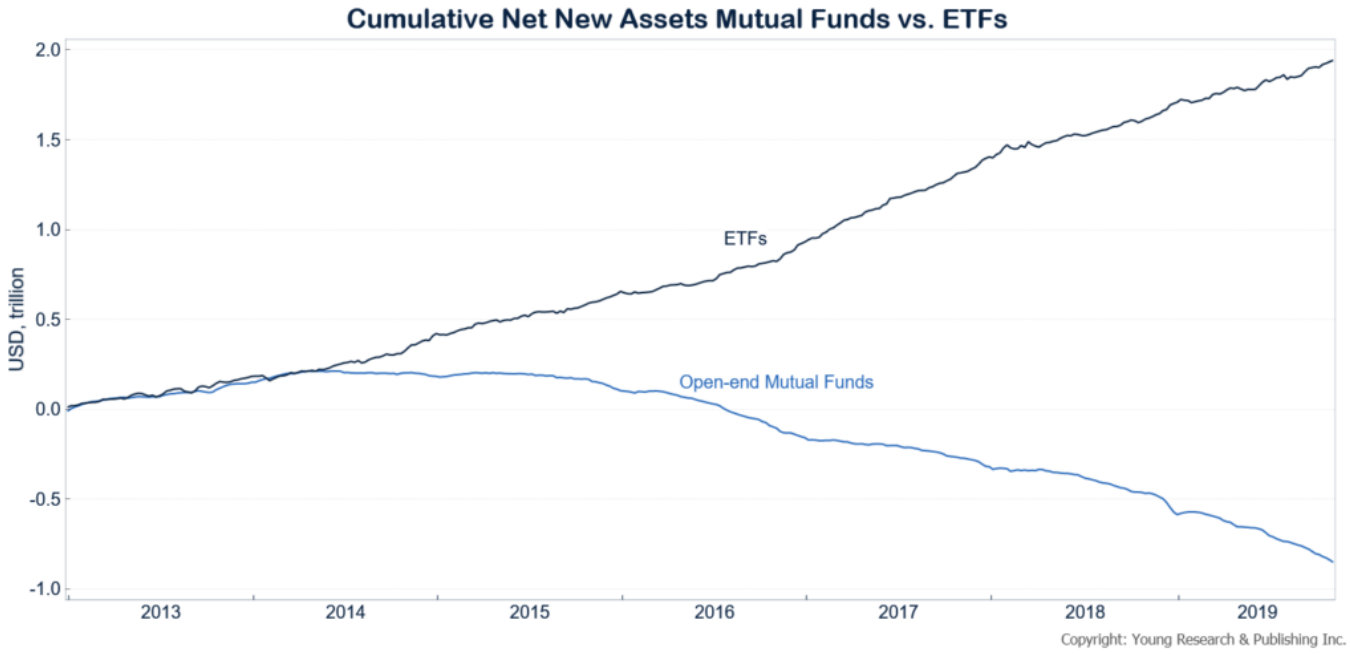
Holding back ETFs' complete domination of the fund industry has been an SEC rule that forced companies offering ETFs to apply for "exemptive orders." Because ETFs weren't technically allowed to exist, companies intending to operate ETFs had to be granted an exception.

Today, with more than 2,200 ETFs in the marketplace, the SEC has finally voted to adopt a new rule to modernize their regulation. The commission announced:

The Securities and Exchange Commission today announced that is has voted to adopt a new rule and form amendments that are designed to modernize the regulation of exchange-traded funds (ETFs), by establishing a clear and consistent framework for the vast majority of ETFs operating today. The adoption will facilitate greater competition and innovation in the ETF marketplace, leading to more choice for investors. It also will allow ETFs to come to market more quickly without the time or expense of applying for individual exemptive relief. In addition, the Commission voted to issue an exemptive order that further harmonizes related relief for broker-dealers.

"Since ETFs were first developed over 27 years ago, they have provided investors with a number of benefits, including access to a wide array of investment strategies, in many cases at a low cost," said SEC Chairman Jay Clayton. "As the ETF industry continues to grow in size and importance, particularly to Main Street investors, it is important to have a consistent, transparent, and efficient regulatory framework that eliminates regulatory hurdles while maintaining appropriate investor protections."

The modernization of the ETF industry is probably the final nail in the coffin of mutual funds. You can see in the chart below the magnitude of investors' move from mutual funds to ETFs. But ETFs aren't much better today. The ETF industry has grown so large; it is facing some of the same issues I noted about the mutual fund industry in 2006. Today, investors are better served by developing a portfolio of dividend-paying stocks, rather than investing in the index ETFs that have become so popular.



If you need assistance in building a portfolio of dividend-paying stocks, fill out the form below. A seasoned member of the investment team at my family run investment counsel firm will contact you to explain our individual stock investing strategy and how you might benefit from it.

Here’s What to Look for As Markets Enter an Election Year

Election years have historically been good to stock market investors. It is now one year away from Election 2020, and market participants are hanging on every word from the candidates. Here’s what I wrote about election year markets back in November 1991:

Remember Tom Mix?

All the great old black and white Western movies of the 1950s, like Tom Mix, featured patented three-part bank robberies that went something like this:

Scene 1: The bank is robbed. Bad guys ride out in a cloud of dust and the chase is on. Scene 2: Bad guys split—one-half to an arroyo or cottonwood grove; one-half to a box canyon. The posse rides by and misses them. Scene 3: After a short and quite harmless wait, the gang unites and rides off in the opposite direction the posse has taken, finally ending up at the shack (how often did movie makers of the 1950s use that same old shack?), where the strong box is shot open and the loot split among the gang.

Those black and white westerns were a lot of fun even though the three-part bank robberies didn’t change much from one show to the next. Maybe it was the repetition that made us so comfortable with Tom Mix, The Lone Ranger and the like.

<u>THE INVESTMENT CYCLE GOES THROUGH THREE STAGES</u>

I want you to look at investing in a similar three-part fashion. There is considerable similarity, in fact, between the old posse-chases-the-gang and the investor-chases-profits in the financial markets. Let me show you how to position *yourself in the three-part investor drama that goes like this:*

Scene 1: The chase is on. Stocks and fixed-income investments offer bargains when yields are high, P/Es are low, interest rates are high and beginning to decline, inflation is on the wane and a recession is at its nadir. The marketplace begins to react to lower interest rates, lower inflation and the first signs of business recovery—and bonds and stocks advance sharply in price. …

Scene 2: The temporary hideout stage is now in place. Investors are clearly nervous and have pulled off the path to wait. And there is reason for nervousness. CD rates and money fund rates have collapsed. The yield on the Dow—it has never ended any calendar year in history below 2.95%—is only 3%. Little looks enticing in the investment markets. Fine—that's exactly how stage two always looks. It is the old where-do-I-go-now? quandary. The answer is not difficult. Just ask yourself what that old gang would have done in Tom Mix's Westerns. You take a break and rest up for the sharing of the spoils that will come your way in stage three of the investment cycle. You let the posse ride by.

President Bush Holds One of the Four Keys to Future Profits

Scene 3: But can you count on a scene 3 to pull you through? Where's the shack, and who'll shoot the lock off the strong box for you? Sure you can count on scene 3. You see, President Bush has an election year coming up. What do we know about election years? That incumbent politicians want to be voted back for another term in office.

We know that for sure. And what do voters hate most when heading out to vote? Crowding their way through long lines of the unemployed. And those in the unemployment lines like queuing up for the dole even less than they like voting for the incumbent. George Bush knows all about election year *politics, as does Federal Reserve monetary maven Alan Greenspan. What's the tonic? Why, lower interest rates.*

Since the election of 1952, the average S&P 500 performance in an election year (the 12 months from November in the preceding year to November in the election year) has been 8.2%.

You can't always depend on an election year though. In that time, there were three election years in which the S&P 500 fell in value. Those were 1960, 2000, and 2008. You'll notice quickly though that none of these elections had an incumbent president running. The incumbents, Eisenhower, Clinton, and Bush, were all finishing their second terms. You may also notice that in each of these three years when the stock market lost value in an election year, the opposition party candidate won the election.

Despite the historic strength of election year markets, you should maintain vigilance in your investment portfolio. Avoid unnecessary risks and focus on income and compound interest. If you need help focusing on what's important in investing, sign up for the client letter from my family run investment counsel firm, Richard C. Young & Co., Ltd. You can sign up by clicking here. The letter is free, even for non-clients.

Big Macs or Sit-Down Service

Today, you can lend $10,000 to the U.S. government, which just closed its books for the year with a deficit of almost $1 trillion, and lock in an income stream of about twelve dollars per month for the next decade.

That's enough to treat yourself and the wife to a couple of Big

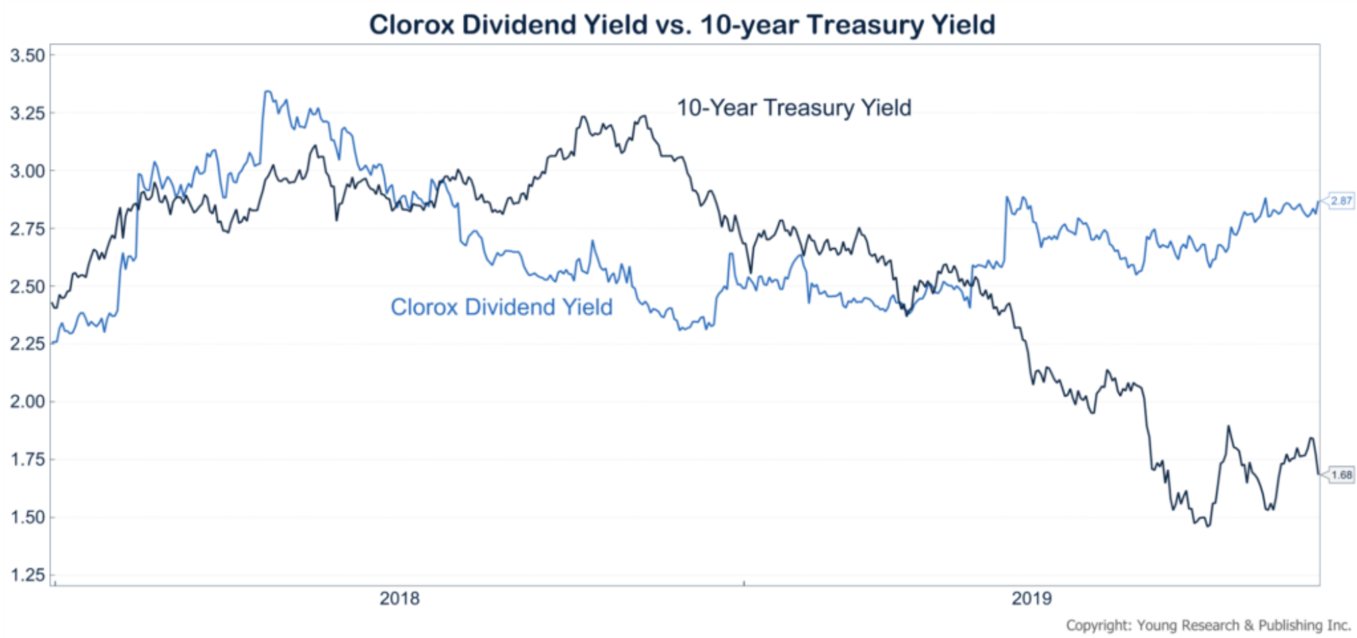
Macs once a month. But if McDonald's keeps raising prices, a couple of years from now, you may need a buy-one-get-one coupon to treat the wife.

The interest payments on government bonds are fixed, and are so tiny today they don't even keep pace with the massaged inflation numbers reported by the Labor Department.

Of course, nobody is forcing you to lend the Treasury Department money. The savvier choice might be to invest $10,000 in shares of Clorox. Clorox will pay you double what the Treasury Department is willing to fork over, and they will likely give you a pay increase every year you are a shareholder.

Filet and lobster won't be on the menu, but you might be able to afford a joint with sit-down service.

The chart below compares the dividend yield of Clorox to the yield on 10-year government bonds. The trade-off today is an easy one.



There are Two Ways to Avoid Investor Overkill

I wrote in March 1991:

> *Listen to me and listen to me hard as I tell you that investors miss the boat over and over because (1) they insist on timing the market, (2) they insist on investing with emotion keyed to events of the moment, and (3) they steadfastly refuse to buy when news is bleak. It's the old buy-high-sell-low game again and again.*
>
> *Most investors regularly equate action with profits. But you don't want a lot of action in your portfolio and you only need to follow a handful of indicators and a handful of investments. Most investors simply cannot help themselves, and that leads to Investor Overkill. The eye is just not kept on the ball. Make it easy on yourself—follow my advice and follow it today.*
>
> *I don't have all the answers. No one does. But I have built my own family portfolio to a seven figure level from ground zero by practicing the very basic slow-and-steady-wins-the-day disciplines I bring to you monthly. I started without a dime (no exaggeration) back in 1964, and I have spent 26 [ed. note, now 55], as a professional investment advisor practicing what I preach.*

Investment Overkill still exists today. There are two ways to avoid it:

1. Keep your investment plan simple. Don't try to do too

much. As an individual investor you lack the resources and time your competitors, institutional investors, can call into battle against you at any time.
2. Hire a professional investment advisory to help you achieve your investment goals.

You can get a better understanding of the value offered by an investment advisory by signing up for the monthly client letter from my family run investment counsel firm, Richard C. Young & Co., Ltd. The letter is free even for non-clients. Signup today by clicking here.

Do You Have the Tools to Carry Out Your Investment Plan?

I regularly meet investors who are going it alone. They are overwhelmed with choices and have little or no investment planning experience. Back in December of 1986, I told investors that they need a game plan and the tools to carry it out. I wrote:

> *"'It was an overcast day.'…Everything on the beach came to a halt…When he passed out 40 Redsand volleyballs,…'it looked like it had rained radioactive bowling balls.'"*
>
> *These graphic quotes from Bruce Anderson's recent "Shoptalk" column in Sports Illustrated describe the beach scene at Manhattan Beach, California when Olympic volleyball star Steve Timmons' newly designed, shocking yellow volleyballs were passed out.*
>
> *It was a great article on Steve and his new sports product.*

Steve Timmons has become somewhat of a Southern California volleyball legend. With his Grace Jones-style red flattop and standing 6’5”, Steve, like his shocking yellow volleyballs, is hard to miss.

I was initially drawn to the Timmons article because I am a long-term volleyball fan and had just recently spent time watching professional volleyball at Laguna Beach. The Sports Illustrated article described the U.S. Olympic team MVP and gold medalist as a “terminal” player, the type of player who is so dominant that “when he hits or blocks a ball, the point is usually over.”

A “terminal” player—strong words with meaning going beyond the world-class player volleyball circuit. The word terminal has a finality to it that few words possess. We would all like to view ourselves as having the ability to drive home the terminal point. One place that such a skill would be most beneficial is in the financial markets, a place where everyone wants to be a winner. But to possess the skill of the “terminal” player takes more than desire.

You need a game plan and the tools to carry it out.

My family-run investment counsel firm can help you develop a game plan and carry it out. If you would like to be contacted by a seasoned advisor who can help you set and achieve your investing goals, please fill out the form below.

Four Ways to Win the Investment Horse Race

In 1993, Julie Krone became the first, and still only, female jockey to win the Belmont Stakes. As Julie, riding Colonial Affair, rounded the first turn, they sat in sixth place. A horse named Antrim Road had dashed out way ahead, taking a big risk with a fast pace.

As the horses came into the far corner, Cherokee Run took the lead, and still, Julie and Colonial Affair remained in sixth place. Then as they turned for home, Julie's patience paid off. The five horses ahead of her had risked it all and gotten tired.

Julie had conserved energy and came on strong in the end to win. Finishing second and third were Kissin Kris, and Wild Gale. All the way back at ninth sat Antrim Road, who had risked it all with the big start. I wrote about Julie in October 1993:

> *A Heavyweight at 95 Pounds.*
>
> *As Julie Krone made the final turn for home in the Belmont Stakes, she realized she was about to capture one of the horse racing's most prestigious Triple Crown events. Later, sitting proudly in the winner's circle, the enormous self-confidence of this 4' 10-1/2" jockey was clearly visible to even the most casual admirers and well-wishers.*
>
> *Self-confidence has made this diminutive young lady a champion. When you consider the massive energy of a 1200-lb. race horse at full gallop, it's not hard to have the greatest respect for a 95-lb. rider with the confidence to rise to the pinnacle of her sport.*
>
> *My goal each month is to give you the strategies you need to generate the same level of confidence in your investing s*

Julie Krone displays in the fast and dangerous sport of thoroughbred horse racing. The development of confidence takes time. It takes dedication. It takes consistency. With consistency comes confidence.

LANDMARK RESEARCH ARGUES AGAINST MARKET TIMING

Recently published results by Professors Chandy and Reichenstein of the Universities of North Carolina and Balor, respectively, show the consistency of long-term returns on the S&P 500. The professors found that by omitting the best 50 months of performance from the stock market's 1926-1987 return, absolutely all the S&P's gains for the entire 61-year period are wiped out. Being out of the market during much of the 50 months would have been a killer to a portfolio.

One of my foundation tenets is that you should not attempt to time the market. Stay fully invested at all times; do not trade in and out. This does not mean that you should not minimize risk (always your first job) and maximize potential total return (appreciation and dividends or interest). You do this by properly diversifying your portfolio to reflect (1) the stage of the economic cycle, (2) momentum in interest rates and inflation, (3) interest rate spreads between fixed-income securities of differing maturities and (4) the current yield of common stocks in general.

These four criteria are objective, clear signs that require no work from you. You do not base your decisions on guesstimates of the future. And you certainly do not engage in market timing.

A steady approach is best for both jockeys and investors. Don't beat yourself in the investment race by creating volatility in your portfolio with market timing. You may miss out on the best days the market has to offer.

If you would like to learn more about the steady investment approach used by my family run investment counsel firm, sign up for the free client letter email alert from Richard C. Young & Co., Ltd. Each month you'll read an update on our investment philosophy. The alert is free, even for non-clients. You can signup by [clicking here](#).

This is the Most Persuasive Test of High-Quality Investing: Does Your Portfolio Pass?

Of all the ways you can test the holdings in your portfolio, Ben Graham codified what he called the most persuasive in his book *Intelligent Investor*. Companies paying dividends for 20 consecutive years were first on Graham's list of high quality. I explained high quality to readers in August 2007, writing:

> ## *Laurent & Villchur…*
>
> *Back in 1967, Acoustic Research's demonstration room on Mount Auburn Street in Cambridge, Massachusetts, was ground zero for state-of-the-art high fidelity. My experiences in Cambridge led me to buy the Acoustic Research AR3 speakers and AR turntable that I am playing today, four decades later, as I write to you. And I am also using the same Dynaco PAT-4 preamplifier and Dyna Stereo 120 power amplifier that first powered my AR3s 40 years ago. AR's founder Edgar Villchur and*

Dynaco designer Ed Laurent were the legendary forces behind this ground-breaking equipment. Today, as I play Johnny Lytle's The Loop, Jack McDuff's Tough 'Duff and The Beatles' Sgt. Peppers, the sound from vinyl is every bit as warm and enjoyable as it was with my earliest AR/Dynaco experiences back in the 1960s.

Vinyl for Warmth

CDs were never collectible and never matched vinyl for warmth. I own a number of high-fidelity systems, including a dearly priced and excellent Conrad Johnson-based reference system. But for day-to-day listening, I turn on my AR/Dynaco system and records—no question about it.

45-RPM Tops

All of this, of course, flies in the face of music industry hype for CDs and downloads, the ultimate in a low-fidelity music experience for the masses. While perfect for jogging and the Wal-Mart experience, this is not high fidelity. And the cherry on the cake of my musical high-fidelity experience for you is the revelation that sound from a properly mastered 45-RPM record is best of all. If you ever saw the classic 1982 movie Diner, you may remember the scene in which Shrevie utters, "Every one of my records means something." Vinyl was and remains the way to go. What I find most encouraging is that young listeners are coming into the vinyl market every day.

Treasured Since 1934

As I write to you today, the single investment book on my desk is the same book that was on my desk when I began in the investment business at Clayton Securities in 1963. Graham, Dodd & Cottles' Security Analysis is as treasured as it was since its first edition in 1934. Like high fidelity, the guts

> *of investing have really not changed so much through the decades. Compound interest, value, and patience are still the key. Ben Graham was fond of saying, "One of the most persuasive tests of high quality is an uninterrupted record of dividend payments for the last 20 years or more." In his Intelligent Investor, Graham followed up with, "Indeed, the defensive investor might be justified in limiting purchases to those meeting this test." Nothing has changed.*
>
> ## *Dividends Since 1893*
>
> *Coke began paying a dividend in 1893, Exxon in 1882, GE in 1899. Things sure have gotten different, haven't they?*

Uninterrupted streams of dividends can lead to a cascade of compounding in your portfolio. Click here to learn more about the value of compound interest, and in particular the powerful Coca-Cola Story.

Are You Confused by the Investment Hype?

As an individual investor, you may be confused by the hype and pressure aimed at you by the media and securities salesmen. The constant drumbeat of news, both good and bad, can create an emotional response from even the most stoic of investors. Couple that with many investors' lack of experience, and trouble can erupt from portfolios during tough market times. In July 1993 I wrote:

You're on the 15th Tee.

At the Four Seasons golf course in Nevis, West Indies, high in the lush green hills of this remote Caribbean island, you are overlooking the yawning expanse of a many hundred foot deep gorge. Where's the pin? Where do you hit? You hit over the gorge to some unseen and distant manicured green. For novices, it would take small-arms fire to hit the other side of the gorge. But for you, the seasoned pro, it's but a well-timed whack with your Wilson #3 wood. No problem, you're on the green.

The challenge of this extraordinary hole on one of the world's most beautiful golf courses is nothing to you, because you are disciplined and practiced, and you concentrate on your game.

Investing is much like golf. Discipline concentration and a practiced stroke are paramount to winning investors as well as to steady golfers. Think about it. Do you apply the same level of concentration to your every investment move as you would on a tricky 20-foot putt? Have you mastered a practiced, mechanical, unemotional approach to your investment program?

Discipline, confidence and a mechanical approach work every time and make sense in many avenues of life. One of my regular monthly goals here is to logically convince you of the value of these vital traits.

Invest With the Slow Ebb and Flow of the Tides

Like many investors, you may often be confused by events of the moment. Media hype and sales pressure are difficult hurdles to overcome. Here, you learn how to overcome emotion in investing. You learn how to harness the awesome long-term power of compound interest and to invest with the slow ebb and flow of the tides. Do not invest on each crashing wave of

> *headline news. If it’s a good idea today, it will be a good idea tomorrow and the next day. Take it easy, relax and do not be an in-and-out trader or market timer. Be ruthlessly organized using the principles found here each month.*
>
> *Invest with the comfort and knowledge that you have a disciplined, long-term strategy. I help you plot your investment map monthly. If you’ve been with me for many years, you know the consistent approach used month to month to month. Over my three decades of investing, I’ve developed a series of disciplines that work well for me, with high odds of success. Each month I stick to these and emphasize their long-term success for you.*

You don’t have to face the emotional task of investing alone. You should seek the guidance of a trusted fiduciary advisor, who will guide you through the construction of an investment plan, and give you the confidence to stick with that plan when times get tough.

If you’d like a glimpse at what a trusted advisor offers investors, signup for the monthly client letter alerts from my family run investment counsel firm. Each month in the letter my son Matt, President and CEO of Richard C. Young & Co., Ltd., explains the ongoing strategies we employ on our clients’ behalf. The letter is free, even for non-clients, and you will receive an alert each month when the newest is available. Click here to sign up.

How to Build 37% of Your Wealth in Just Ten Days

In the Spring of 1996, I explained how important just ten days of a 31-year period were to building 37% of their wealth. I wrote that March:

> ***Market Timing Strategy—Bankrupt***
>
> *Before I tell you what other funds I have bought this month and which funds I have on my short list for the next few months, I want to startle you, shock you, and convince you beyond any doubt that market timing is a bankrupt strategy whose time has never come.*
>
> *Here's the only example you'll ever need to never market time again. T. Rowe Price put these numbers out a year or so ago. The original research was done by Towneley Capital Management.*
>
> *If you invested $1 for a 31-year period (1963-1993), your $1 grew to $24.30 at year-end 1993. But if you missed just the 10 best trading days out of the 7,802 trading days, your $1 investment grew to only $15.40. That's right, by missing just 10 days, your return was slashed by 37%. Do you know what percentage of the trading days we are talking about here? Less than one-quarter of one percent (0.128%).*
>
> *Now then, if instead of only 10 days you missed the best 40 days of 7,802 trading days, your $1 grew to only $6.50. By missing just 0.51% of the total trading period, your return was slashed by an unimaginable 73%. How's that for missing the boat?*
>
> *OK, what if you missed out on just 1.15% of the trading days? Well, by missing just 90 of the total 7,802 trading days, your $1 made a glacier-like advance to $2.10. You would have been*

> *head-faked out of 91.4% of your long-term profits.*
>
> *Still with me? The news gets worse—a lot worse. In-and-out trading necessitates not one, but two correct buy/sell decisions. It does no good to get out of the market advantageously unless you can also get back in advantageously—and both are low odds, big "ifs." Furthermore, there is a substantial transaction penalty to pay on each and every buy and sell. You find commissions extracted from your hide. And you do not see the bid/ask spread that is also lost on each transaction.*
>
> *Finally, in all non-tax-deferred accounts, a tax penalty will be extracted. And depending on your location, the onerous nature of state and local taxes along with federal taxes may be a back snapper.*
>
> *Market timing is akin to trying to draw an inside straight in poker or to yank the mask off the Lone Ranger. Not good ideas—not good ideas at all.*

You won't be able to pick which days you earn your 37%, but if you remain invested with a balanced portfolio and a strong investment plan created with your advisor, you won't need to. The market will do the work for you.

This Decision Could Lead You to Financial Disaster

Odd things are happening in the economy right now. The most obvious is the recent destruction of oil facilities in Saudi Arabia. But there are also subtler, less obvious warning signs, including the first injections of liquidity into markets by the Fed in 10 years on Tuesday and Wednesday.

Couple that with the Fed’s lowering of the Fed Funds rate despite economic growth and low unemployment, and things appear uneasy. These are the times at which it would be easy to make an investment mistake. I wrote in July 1995:

> *“My name’s Marlow. General Sternwood wanted to see me.”*
>
> *Devotees of the classic black-and-white Hollywood films now hear original wording from Raymond Chandler’s 1939 movie, The Big Sleep, introducing a new CD produced by Charlie Haden.*
>
> *Haden, viewed by many as today’s dominant voice in jazz bass, recently integrated to stunning effect a lead using the nostalgic Warner Bros.’ Fanfare theme music and the Marlow spoken word line as preludes to his own original composition Always Say Goodbye.*
>
> *Always Say Goodbye was inspired by the few times Charlie felt he had not properly said goodbye to friends or family who, unknown to him at the time, he would never see again.*
>
> *Haden’s thoughtful weave of Hollywood movie, theme music nostalgia and his own original composition reflecting his agony over failing to say goodbye built an emotionally charged piece of music that has rewarded him with the Down Beat International Critic’s Award for jazz album of the year.*
>
> *In Always Say Goodbye, it was emotion that helped Charlie Haden win success. Unfortunately, in the world of investing, unlike musical composition and execution, emotion can be the trigger to financial disaster not success.*

Responding to market movements emotionally or irrationally is possibly the worst mistake an investor can make with his money.

To give you an indication of how emotional a bad day in the market can get, imagine two scenarios. In both scenarios, you’re a 67-year-old who has $1,000,000 saved for retirement.

In the first scenario, imagine you have put $50,000 cash in a briefcase, and you’re headed along a crowded street to your bank to deposit it. Suddenly someone grabs the briefcase and runs off, never to be seen again. You never even had a chance to say goodbye. How emotional would you be? If you’re like most Americans your heart is pumping, you’re breathing heavily, you’re scared, and you want your money back.

In the second scenario, imagine your $1,000,000 is invested in the stock market, which drops 5% in a day. On paper, you’ve lost $50,000. On average since 1928, the S&P 500 has fallen by over 5% in a single day about once every year-and-three-months. If you panic, get emotional and sell everything in the face of this loss, you’re no better off than when the thief stole your briefcase. That money is gone forever.

The difference between scenario one and scenario two is that in the second scenario if you have confidence in your investment plan and an advisor to guide you through the turbulence of markets, you have the opportunity to avoid an emotional mistake, to avoid financial disaster, and even to get your money back.