

Comprehensive Investment Management, LLC

Fee Only Personal Financial Planning

Summer 2018

A Review of the Financial Markets at June 30, 2018

Vanguard's Total Stock Market Index Fund returned 3.9% over the first half of 2018, while Vanguard's counterpart for foreign stocks lost 3.6%. The Total Stock Fund tracks all US stocks, the Total International Index Fund tracks all foreign stocks. The US markets have soldiered on because of strong corporate profits, despite rising interest rates, rising costs, labor shortages, volatility, and turmoil in European politics. I could also mention US political uncertainty and trade wars. At the start of the year hopes for global growth were high, but Europe, Japan and the emerging markets including China, the second biggest economy in the world, are coming well below those expectations.

The following article and accompanying charts describe the performance of a select group of mutual funds. Recent market activity can be newsworthy, but for investment purposes performance over longer periods, while not predictive, is significantly more meaningful.

US Diversified Stock Funds

Our diversified stock funds averaged 2.5% for the quarter, 5.9% so far in 2018, and 18.7% for the last twelve months. At one year, three, five, ten and fifteen years our funds outperformed Vanguard's Total Stock Market Index Fund by an average of better than 2.3%. Our best performer, Brown Capital, is on a tear at 9.7% for the quarter and 28.9% for twelve months. A bit surprising, the worst performer for us in the quarter was midcap Primecap Odyssey Aggressive Growth down 2.6%. The Primecap large cap funds struggled as well, with Primecap Growth down -.7% and Primecap Stock ahead, but just by .2%.

US Stocks	Qtr	1 yr	3 yr	5 yr	10 yr	15 yr
Large Cap	1.4	15.9	13.5	14.7	11.6	11.1
Mid Cap	0.0	20.8	15.6	17.9	14.7	12.8
Small Cap	7.8	24.0	15.1	16.7	14.1	12.8

Sector Stock Funds

This is the last time we will include Vanguard's Energy Fund in this section of the quarterly review. Our gradual reduction toward a zero allocation to energy reached its goal with final sales in May, when oil reached \$80 a barrel for the first time in a long time. We first bought into the Energy Fund shortly after the Great Recession. Prior to that crisis, the fund had been closed to new investors for years, having consistently provided double digit returns. During our time in the fund, we averaged a 2% to 4% annual return. The

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Mutual Fund Categories	Quarter Return	Average Annual Percentage Returns Through June 30, 2018				
		1 Year	3 Years	5 Years	10 Years	15 Years
Short Term Bonds	0.2	-0.1	1.1	1.4	2.4	2.7
Intermediate Term Bonds	0.0	-.4	1.8	2.3	4.0	4.2
US Diversified Stocks	2.2	17.5	13.7	15.3	12.6	11.9
Energy, Health & Real Estate Stocks	6.7	11.5	5.6	8.9	7.4	11.0
Foreign Stocks	-3.1	14.7	10.3	9.8	7.4	11.4

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The Financial Markets (from page 1)

energy industry has been seriously disrupted by over supply, a large part of which was due to the vast expansion of production in the US. Recently geopolitical gyrations have taken a toll on the industry, and we should do better investing in markets not so conflicted. A phaseout of our investments in T Rowe Price's (TRP) Real Estate Fund is now underway, as we invest in the Wellington and Wellesley funds to move us more into the mainstream. Our investments in healthcare have turned into a tale of two subsectors. Over the last twelve months TRP Health Science has returned 15.3% and Vanguard's Healthcare just 2.1%. TRP's tilt toward innovative therapies is carrying the day.

Sectors	Qtr	1 yr	3 yr	5 yr	10 yr	15 yr
Energy	9.0	22.1	5.7	2.4	-0.7	9.7
Health	3.4	8.7	4.2	16.1	15.1	13.3
R/Estate	7.6	3.7	6.9	8.1	7.8	10.1

Foreign Stock Funds

The US is the single biggest market in the world, representing almost 30% of the global economy. So you can imagine how disrupting new and expanded trade tariffs will be for the bigger companies that are built around free trade. Brazil had the roughest first six months of the year with inflation, high unemployment and dropping currency. Recent increases in the price of oil slowed growth in India, which imports much of its energy. As a result the Emerging Market Select Fund dropped 9.7% for the quarter, while T. Rowe Price's International Discovery lost just -.4%. The funds are still well in the black over the last twelve months and beyond.

Bonds vs. Stocks

The paltry returns of the bond funds are showing up in the competition between the Wellesley Fund (65% bonds and 35% stocks) and the Wellington Fund (35% bonds and 65% stocks.). In normal times, a bond yield curve is expected to show longer term bonds providing a higher yield than the short term variety. That's expected because risk and return are highly correlated, and the long term bond risk is higher because money is committed for a longer time. A comparison of the Wellesley fund to the Wellington fund can be viewed the same way, with the question: Has the added risk of Wellington been rewarded?

Return	Qtr	1yr	3 yrs	5 yrs	10 yrs	15 yrs
Wellesley	0.3	3.1	5.8	6.1	7.4	6.7
Wellington	0.7	6.8	7.9	8.8	8.0	8.4

Looking Ahead

We appear to be moving into an era of global trade dominated by politics rather than economics. The Trump administration is convinced that a tough approach is needed to stop other countries from taking advantage of the US. It wants to end trade practices it sees as unfair, and the dependency of our allies on an over-accommodating US for things like military protection. Although China doesn't agree, there's a general consensus that China's trade practices are unfair, especially when it comes to intellectual property. But another consensus is that tariffs on China, let alone those on allies, are not the solution. Commerce Secretary Wilbur Ross says we are trying to fix long ignored problems, so we should expect some "pulling and tugging." The Chamber of Commerce, which is customarily a close ally of the Republican Party sees things differently, and has launched a campaign to oppose Trump's trade policies. The US Senate agrees, passing one of those non-binding resolutions. Nobody wins a trade war. The Trump administration apparently thinks a trade war, if not protracted, will be successful. The South thought the Civil War would be over in weeks. Others thought the same thing about World War I.

The US markets have held up primarily because of a strong economy and corporate profits that were up in the first quarter by 26%, with 20% estimated for the second quarter. The question now is whether companies can continue to meet rosy predictions. The expected boost to the US economy from tax cuts may be offset by rising consumer prices driven by tariffs. The Federal Reserve will continue to raise rates and reduce its balance sheet in an attempt to normalize capital markets after ten years of economic accommodation. Signs of rising inflation will spur higher interest rates as well. The labor market is as tight as it has been in many years, and producer prices, gasoline and other energy prices are on the rise. Stay tuned. Stay diversified.

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Reporter's Roundup

TRADE WARS:

On June 21st Vanguard increased the odds it had on a full scale global trade war to 1 in 3 up from 1 in 10 from a few weeks earlier. If it was putting out an announcement today, the odds would be higher. It estimates that a trade war environment could reduce GDP by 1.7% and increase inflation by .4% annually. In that case, the US Federal Reserve would be forced to pause interest rate increases and choose between bolstering growth and suppressing inflation. Of real importance is the broader and longer term implications of global trade policy. Vanguard concludes that the lessons of history will prevail. Referencing the 1930's lowering of trade barriers and realization of economic integration, it thinks it unlikely the Trump administration will risk disrupting domestic growth by dramatically shifting trade policy. Still Vanguard believes it worthwhile to closely monitor US policy decisions—and the responses from America's trading partners—for signs of escalation.

VANGUARD'S "UPGRADE":

In January CIM's CEO wrote to his counterpart at Vanguard, Tim Buckley. He urged him to not make the alleged "upgrade" mandatory. There had been unconfirmed reports that was Vanguard's intention. Those who have seen the letter say it was blunt, but somewhat short of scathing. Although the CIM CEO received a sympathetic call from his Vanguard representative, there has been no other response. CIM's CEO plans to write again.

Vanguard has posted a notice on its website: *"How do I re-establish my account services after my upgrade? It starts by saying "we've noticed that some services that you previously enjoyed can get interrupted during the upgrade process. Here's how to fix them:"* It then describes the procedures to follow, which are the same as if the services had never been there in the first place. And no apology offered. In his letter CIM's CEO wrote that not telling its customers ahead of time what would happen after the alleged upgrade was dishonest. *"We've noticed"*. Really? In fact, when "UPGRADE" was selected, the first message to come up included a small-print description of the services just lost.

VANGUARD BENEFICIARY FORMS:

You may have noticed a reduction of forms available on Vanguard's website. That's because Vanguard, like many other firms, want you to conduct as much business as possible on line. If you want a particular form, you may have to call and ask for it. One example is the beneficiary change form. Designating beneficiaries is a big deal, and I have often wondered why Vanguard makes it so easy to change them on line. I suspect there are lawsuits aplenty.

On line beneficiary choices are limited and are kept quite simple. For example: "To the person I am married at the time of my death", and "To my descendants who survive me per stirpes". (Per stirpes means a descendant's descendants if he or she predeceased). If you have special circumstances, you should submit paper forms, and the Wealth Transfer Department will let you know if Vanguard doesn't feel it can comply with your instructions. You only hear from them if there is a problem, so after allowing for processing time, you should go on line to see what shows there.

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Q & A

Q: Warren, thanks for taking my question. Do you know a good financial adviser in the Philadelphia area? In the annual review recently prepared by my current adviser he showed correctly that I am invested in the mutual fund Brown Capital Management Small Cap Fund. However, in the accompanying chart comparing my stock holdings to the overall US market, he showed my investments in small cap companies at zero. I figure if he can make an obvious mistake like that, then how do I know that everything else in the report isn't wrong? So there has been a loss of confidence.

Guest columnist
Warren E. Buffet.

A: I agree having confidence in your advisor is essential, right up there with trust. In your case, I don't think you have a problem. It turns out that Brown Capital Management Small Cap Fund (BCSIX) has morphed into more of a mid cap fund than a small cap fund. Vanguard changed the fund's category about two months ago, and Morningstar agrees. Morningstar currently shows the Fund's stock breakdown as 6% large cap, 56% mid cap and 26% small cap.

The Brown fund has earned a Five Star Gold rating for years. Over the last year it returned 32% and 18.5% per year over the last five years. You want more? How about 14% over the last fifteen years, while the S&P returned 9.1%. Over fifteen years \$20,000 in the fund grew to \$161,000, with the S&P you're at \$78,000. Vanguard's biggest small cap fund, Explorer, has a fifteen year annual return of 10.6%.

I never envied small cap fund managers. They search for potentially successful small companies. Then when they find them, guess what? The company's success leads to expansion, and eventually the company is no longer small. I suspect that's what is happening at Brown, and in time it will return to the small cap category.

As far as your adviser, he sounds like a keeper. Brown was an excellent choice. Next thing you'll be telling me is that besides a comprehensive annual review, he provides extensive quarterly summaries, helps with your taxes, your budgeting and estate planning. I told my wife that when I pass she should put all her investments into a S&P 500 index fund. That is probably the stupidest thing I ever said in my life. When I get home tonight I'm going to tell her to move to Philadelphia instead.

Submit your questions at CIMontheweb.com.