STEWARD

SEPTEMBER 2022

A QUARTERLY PUBLICATION OF ALLODIUM INVESTMENT CONSULTANTS ▪ VOLUME 15, ISSUE 3

An Index Overview

Part 4: Opportunities & Obstacles

Legend has it, a pharmacist named John Pemberton was searching for a headache cure when he tried blending Coca leaves with Cola nuts. Who knew his recipe was destined to become such a smashing success, even if Coca-Cola® never did become the medicine Pemberton had in mind?

In similar vein, when Charles Dow launched the Dow Jones Industrial Average (the Dow), his aim was to better assess stock prices and market trends, hoping to determine when the market's tides had turned by measuring the equivalent of its incoming and outgoing "waves." He chose industrials (mostly railroads) because, as he proposed in 1882, "The industrial market is destined to be the great speculative market of the United States."

While the actively minded Dow never did achieve market-timing clairvoyance (and neither has anyone else we're aware of), he did devise the world's first index. We'd like to think his creation turned into something even greater than what he'd intended—especially when Vanguard founder John Bogle and other pioneers leveraged Dow's early work to create among the most passive ways to invest in today's markets: *the index fund.*

Bogle launched the first publicly available index fund in 1976. Initially dismissed by many as "Bogle's folly," its modern-day rendition, the Vanguard 500 Index Fund, remains among the most familiar funds of any type.

Index Investing is Born

In defense of Dow's quest to forecast market movements, it's worth remembering that his was a world in which electronic ticker tape was the latest technology, there were no open-ended mutual funds or fee-only financial advisors, and safeguards and regulations were few and far between. Essentially, speculating was the only way one could invest in late-nineteenth century markets Compared to actively managed funds that seek to "beat" the market by engaging in these speculative strategies, passively managed index funds offer a solid solution for sensibly capturing available market returns. As the name implies, an index fund buys and holds the securities tracked by a particular index, which is seeking to represent the performance of a slice of the market. For example, the Vanguard 500 Index Fund tracks the popular S&P 500 Index, which in turn approximately tracks the asset class of U.S. large-company stocks.

Index funds lend themselves well to helping investors more efficiently and effectively target three pillars of sensible investing:

- **Asset allocation** – How you allocate your portfolio across various market asset classes plays a far greater role in varying your long-term portfolio performance than does the individual securities you hold.
- **Global diversification** – Through broad and deep diversification, the sum of your whole risk can actually be lower than its individual parts.
- **Cost control** – The less you spend implementing a strategy, the more you get to keep.

Evidence-Based Investing

As we've described, indexes weren't specifically devised to be invested in. There's often a lot going on underneath their seemingly simple structures that can lead to inefficiencies by those trying to retrofit their investment products on top of popular indexes.

Asset allocation is based on the premise that particular market asset classes exhibit certain risk and return characteristics over time. That's why your investment "pie" should be carefully managed to include the right asset class "slices" for your financial goals and risk tolerances. If you're invested in an index fund and you aren't sure what its underlying index is precisely tracking, you may end up with off-sized pieces of pie. For example, the S&P 500 and the Russell 3000 are both positioned as U.S. stock market indexes, but both also track some real estate. If you don't factor that into your plans, you can end up with a bigger helping of real estate than you had in mind.

Academically minded innovators from around the globe soon sought to improve on index investing's best traits and minimize its weaknesses. In fact, many of these thought leaders were the same early adapters who introduced index fund investing to begin with. Building on index investing, they devised evidence-based investment funds, to offer more advantages:

Index-Independence – Instead of tracking an index that tracks an asset class, why not just directly capture the asset class itself as effectively as possible? Evidence based fund managers established their own parameters within the targeted asset class.

Focusing on Innovative Evidence – Evidence-based investing shifts the emphasis from tracking an index, to continually improving our understanding of the market factors that contribute to the returns we are seeking. By building portfolios with this same evidence, you can make use of existing academic insights, while incorporating credible new ones as they emerge.

Remember that indexes do not help us forecast the markets. Nor does the Dow foretell when to buy or sell your market holdings. Low-cost, well-managed index funds may play a role in your investment portfolio; select them when they are the best fit for your evidence-based investment strategy, not simply because they are a popular choice.

Until next time, no regrets!

Eric Hutchens
Chief Investment Officer

FINANCIAL PLANNING TIP

Small Moves Can Have an Impact

Financial planning is about making smart decisions that will benefit you over the long run. However, not every decision involves a major change or a lot of money. Sometimes the small things can really add up, and the following tips might just improve your financial situation a little bit.

Do You Get the Most From Your Credit Cards?

Do you maximize your travel rewards, cash back, discounts and other bonuses offered by credit cards? There are several great comparison websites that will help you choose the best card or cards for you. Two of the main ones are Nerdwallet.com and WalletHub.com.

For those who like cash back cards, it has been a long time since a card has offered a flat 2% cash back with no special categories to worry about. Wells Fargo has such a card providing 2% cash back that may be worth checking out (see Wells Fargo Active Cash Card). It helps to think about what 2% cash back could mean if your household puts say $5,000 per month on a card. You could get back $1,200 per year, which certainly pays for the hassle of switching.

Are You Using a Pledged Asset Line of Credit at Schwab?

If you have a taxable portfolio of at least $100,000 at Schwab, you may be able to set up a flexible line of credit using your investment portfolio as collateral. This line of credit can be used for almost any purpose, but it is best used for shorter-term loans due to the variable nature of the markets. Many people use it for a bridge loan when buying a home, or for a remodeling project. You can borrow up to 70% of the value of your pledged assets, so if markets go down you may have pay back some of the loan to keep within the 70% requirement or you could also pledge additional assets. The interest rate is usually lower than a bank loan, and it does vary by the dollar value of securities you pledge as collateral. The higher the value of the securities you pledge, the lower your interest rate. Having the flexibility to draw on this line could help you avoid having to sell assets and potentially incur capital gains taxes or tie up your cash.

Is Your Cash "Stash" Earning Anything?

With interest rates going up, there are finally some options to earn a little bit more on cash. On-line, high yield saving accounts are paying as much as 2.21%, and CD rates are going up as well (see Nerdwallet.com or Wallethub.com for more information). It is important to keep your emergency fund liquid and accessible, so make sure you have appropriate access to your money if you do choose a CD.

Upcoming Webinars

September 22, 2022 at 2:00 – 3:30 p.m. Central Time

Retirement Income Planning: How the Bucket Strategy Can Help

The Bucket Strategy can be applied to retirement income planning. If you are looking for ways to optimize your retirement income planning strategy, this webinar is for you. Even if you are not planning for retirement, you can still apply many of these concepts to your unique situation and portfolio.

October 20, 2022 at 2:00 – 3:30 p.m. Central Time

8 Ways to Enhance Donor Trust by Improving Your Investment Stewardship

Kathleen McBride, AIFA®, BCF™
Founder, Fiduciary Path™, LLC

Allan Henriques, AIFA®, BCF™
Analyst, Fiduciary Path™, LLC

Allodium is thrilled to welcome back Kathleen McBride and Allan Henriques from FiduciaryPath, LLC. This webinar is a guide to walk nonprofit leaders through the steps of becoming a better fiduciary while also increasing the trust and possible contributions of your donors.

For more information about how to register for our webinars, please contact iavraamides@allodium.com.

2022 Headlines

- Allodium is thrilled to announce three employee weddings within May and June 2022. Congratulations go to Carter and Naomi (Black) Rogness, Derek and Kelly (Kleine) Van Calligan, and Eric and Brie (Lee) Olson! Take a minute to wish them well.
- Dave Bromelkamp was a moderator at the 4th Annual Private Wealth Great Plains Forum presented by Markets Group on July 27, 2022. The topic was "From Real Estate to Real Assets: Seeking the Best Opportunities."
- In the July 2022 issue of Financial Advisor (FA) Magazine, Allodium was named as one of the Minnesota Registered Investment Advisory (RIA) firms in FA's 2022 RIA Survey and Ranking.
- Dave Bromelkamp will be a speaker for the ESG session at the 8th Annual Great Plains Institutional Forum presented by Markets Group on September 13, 2022.
- Allodium was pleased to welcome two new clients in the second quarter of 2022.
- Our office will be closed September 5, November 24 and 25 for company holidays.

To find out more about Allodium's breaking news, please visit our website: www.allodium.com.

WE APPRECIATE YOUR INTRODUCTIONS

To optimize our objectivity and avoid conflicts of interest, we are a fee-only registered investment advisor that is completely independent from banks, brokerage firms and other financial product providers. If you know someone who may be looking for this type of objective investment advice, please contact Dave Bromelkamp at 612-230-3702 or dbromelkamp@allodium.com to arrange a friendly, no-obligation introduction.

Steward is published quarterly by Allodium Investment Consultants. Please contact iavraamides@allodium.com if you have any comments about this publication or wish to be added to or removed from our mailing list.

ALLODIUM INVESTMENT CONSULTANTS 2005 15 YEARS 2020