Power Of The TCC To Invest In Vanguard Mutual Funds As Proposed:

The TCC currently holds more than $51,500 in a Vanguard Funds Prime Money Market Fund generating in the range of 0.03% to 0.04% annual return. The return for all of 2012 was in the range of $20.

The Bylaws of the TCC (see addendum) do not appear to contain any provisions that would prevent the TCC from investing the funds currently held in the Vanguard Funds Prime Money Market Fund in other mutual funds in the Vanguard Mutual Fund Family.

Section 7.02 of the Bylaws allows the Board of Directors to select depositories for TCC funds. I am assuming that Vanguard has been properly selected.

Section 7.13 allows "The TCC . . . to invest and re-invest funds held by it, according to the judgment of the Board of Directors without being restricted to the class of investments. . . ." The only restriction involves prohibited transactions under Section 4941 through 4945 of the Internal Revenue Code which would appear, on cursory examination, to apply to the TCC if it were to become classified as a Private Foundation and may relate to the amount of its funds and income that the TCC spends on its purposes rather than investments of the sort contemplated. If the TCC earns more, it might have to spend more on the community, and that's not a bad thing.

The TCC's tax professional should be consulted regarding possible additional spending requirements if and when additional income materializes. Relevant provisions of the Bylaws are attached as an addendum. The entire bylaws are reproduced on the TCC website at tierrasantacc.org.

Investment Proposal:

A fundamental question is whether the TCC should accept the risk of loss of principal in exchange for the possibility of gain. The question, more properly, is what should be a prudent balance between risk and return. Although the current scenario does not contain risk of loss of principal, it is not risk-free, as it contains inflation and opportunity-cost risks. For example, if the account had been invested in the suggested allocation five years ago and untouched to date, it would have lost principal in the recession of 2008-9 but would have gained $19,000+- overall. (see spreadsheet)

To begin my presentation, I'd like to offer some thoughts from a person who has a fair amount of investing experience: Warren Buffet, Chairman of Berkshire Hathaway. I think the psychology of the approach to investing is of key importance. I offer the quote for his psychological mindset. While one shouldn't ignore short term factors, it is important to keep one's eye on the long term, big picture which he provides.

"A thought for my fellow CEOs: Of course, the immediate future is uncertain; America has faced the unknown since 1776. It's just that sometimes people focus on the myriad of uncertainties that always exist while at other times they ignore them (usually because the recent past has been uneventful).

American business will do fine over time. And stocks will do well just as certainly, since their fate is tied to business performance. Periodic setbacks will occur, yes, but investors and managers are in a game that is heavily stacked in their favor. (The Dow Jones Industrials advanced from 66 to 11,497 in the 20th Century, a staggering 17,320% increase that materialized despite four costly wars, a Great Depression and many recessions. And don't forget that shareholders received substantial dividends throughout the century as well.)

Since the basic game is so favorable, Charlie and I believe it's a terrible mistake to try to dance in and out of it based upon the turn of tarot cards, the predictions of "experts," or the ebb and flow of business activity. The risks of being out of the game are huge compared to the risks of being in it."

(Berkshire Hathaway 2012 Annual Report, Warren Buffet's Letter, p. 5-6)

I chose Vanguard because the money is currently held there in a mutual fund and Vanguard is an excellent choice for an investment depository because of its stability, prudent management, and culture emphasizing low management costs. It is a no-load fund family so there would be no up-front or withdrawal cost to enter or exit different mutual funds in the Vanguard Group.

In considering an investment approach I recognized that over the long term there may be people with higher and lower skill levels managing the portfolio. Therefore I selected investments that should perform adequately, fully invested over decades with little or no active management by the Council, assuming Vanguard Funds retains its core cultural values.

The investments represent a roughly balanced bond and dividend income, and capital gain approach. The Admiral Balanced consists largely of equities and bonds; the Equity Income largely dividend paying equities; and the Intermediate Bond Fund, intermediate duration bonds.

Risks are probably greater over the short term and relate to the entry process rather than the soundness of the investments.

Two countervailing principles are trends and reversion-to-the-mean. Over any time frame, both occur. Prices move in shorter term trends in a direction for a while and then return to longer term trends. If one enters near the culmination of a shorter term uptrend and the next move is down there will be a loss before the shorter term reversion-to-the-mean downtrend reverses into the longer term uptrend. A phenomenon called whipsaw can occur. If one waits until a trend seems obvious before entering, and then is quickly confronted with a reversion down-move, causing a hasty exit, followed by a resumption of the uptrend and a delayed re-entry the loss can be greater than if one simply entered and held. For example, an investor may start watching an investment at 100, decide to invest when it moves to 110. It may then start to move back down and the investor may sell at 105. The trend may then reverse and the investor may watch it again for 10 points and buy back in again at 115.

On the other hand, if one doesn't sell at 105 and it is actually a longer downtrend, one can lose a significant amount of initial capital through inaction.

It is hard to get the right mix of humility and conviction. One is always working at the right edge of the chart. You can see what has happened but not what will.

Keeping all of those factors in mind, I suggest initially investing slightly more than the account opening requirements in the three different funds, a total of $20,000. That is approximately 40% of the existing account balance.

$12,000 --Vanguard Balanced Index Admiral Fund (VBIAX),

$ 4,000 --Vanguard Equity Income Investors Fund (VEIPX,

$ 4,000 --Vanguard Intermediate-Term Investment Grade Investors Fund(VFICX).

$20,000 Total Initial Investment.

Following that I suggest an automated monthly Dollar-Cost-Averaging approach with $2,000 per month, invested mid-month, allocated between the three funds in the same proportion as the initial investment over the next 15 months until the account is fully invested, less a nominal cash balance of $2,000+-. Dividends are to be reinvested. Some extra investments could be made, depending on circumstances, in the late spring/early summer and mid to late fall which are frequently times of pullback that provide lower stock prices.

Liquidity is not a major consideration since all the funds can normally be redeemed and cash transferred to the associated Vanguard money market fund or other Vanguard cash management account at the close of any trading day by means of an order placed prior to the close of the same day. Since the money is already in a Vanguard Money Market Fund the investment process involves simple transfers.

The benefit of the Dollar-Cost-Averaging approach is that more shares are purchased when prices are lower. The benefit of a phase-in is that it can be set up to occur automatically and the amount invested is lower initially when the risk of bad trading decisions due to temporary pullbacks is higher. The comfort level should increase as the investments are held longer and hopefully an investment return cushion accumulates relative to the existing flat-line return scenario.

In the short term, if some unexpected, large impact negative event occurs-for example a new Korean War or Mid-East War or . . . . (One can imagine myriad hypotheticals), the investment process can be halted and/or perhaps half of the investments can be redeemed. In the long term, risk can be limited by withdrawal of a percentage of the investments. However, with these funds and allocations, buy-and-hold is not a bad strategy either. Not infrequently, by the time any bad news event is disseminated, the drop in prices has already occurred so withdrawal simply locks in losses and precludes regain. Stuff happens, but these funds should weather stuff well.

Periodically, perhaps on 2-4 year intervals, the amounts can be rebalanced to the original proportions.

In conclusion, I suggest a phased investment approach into a diversified mix of highly rated, largely passively managed, low cost Vanguard mutual funds followed by an extended holding period with little or no trading.

Addendum:

7.02 Deposits and Withdrawals

The Board of Directors shall select banks, trust companies , or other depositories in which all funds of the TCC not otherwise employed shall, from time to time, be deposited to the credit of the TCC.

7.13 Investments

The TCC shall have the right to retain all or any part of any securities or property acquired by it in whatever manner, and to invest and re-invest funds held by it, according to the judgment of the Board of Directors, without being restricted to the class of investments which a Director is or may hereafter be permitted by law to make or any similar restriction, provided, however, that no action shall be taken by or on behalf of the TCC if such action is a prohibited transaction under Section 4941 through 4945 of the Internal Revenue Code of 1954, or corresponding provisions of any subsequent federal tax laws.

The TCC is a Section 501(c)(4) organization roughly defined as follows according to Wikipedia:

501(c)(4) organizations are generally civic leagues and other corporations operated exclusively for the promotion of social welfare, or local associations of employees with membership limited to a designated company or people in a particular municipality or neighborhood, and with net earnings devoted exclusively to charitable, educational, or recreational purposes. . . .

Contributions to 501(c)(4) organizations are usually not deductible as charitable contributions for U.S. federal income tax, with a few exceptions.[34] 501(c)(4) organizations are not required to disclose their donors publicly.[35]

Wikipedia, 501 (c)(4) organization description.