Put Buffett's Advice Into Action With These Two ETFs

May 3, 2016 **Eric Balchunas |** ***Bloomberg***

(Bloomberg) -- Warren Buffett's advice may now extend beyond the grave.

When the Oracle of Omaha went out of his way to trash hedge funds and endorse low-cost index funds, it wasn't just a case of "do as I say, not as I do." He had already laid out plans to allocate his personal fortune this way. Here's what Buffett wrote about his last will and testament in a letter to shareholders about 2013 results (pdf):

"My advice to the trustee could not be more simple. Put 10% of the cash in short-term government bonds and 90% in a very low-cost S&P 500 index fund. I believe the trust's long-term results from this policy will be superior to those attained by most investors—whether pension funds, institutions, individuals—who employ high fee managers."

While there is no exchange-traded fund that does this per se, investors might easily put Buffett's advice into practice with a mini-ETF portfolio--let's call it the "Buffett Special." Simply allocate 90 percent of your money to the Vanguard S&P 500 ETF (VOO) and 10 percent to the iShares 1-3 Year Treasury Bond ETF (SHY).

The Buffett Special portfolio comes with a near invisible blended fee of 0.06 percent, which is only 1/12th the asset-weighted average for active mutual funds. It's less than 1/30th of the typical 2 percent charged by a hedge fund (and that isn't counting performance fees, which are usually 20 percent on any profit).

And what about the returns?

The Buffett Special has a 10-year annualized return of about 7.5 percent through the end of June 2015. That's better than the average endowment return of 6.3 percent through the same time period, according to the National Association of College & University Business Officers. It also bests the average pension return of 6 percent, according to the Wilshire Trust Universe Comparison Service. So Buffett's not kidding when he says this miniportfolio will beat even the most sophisticated institutions. It's not entirely a fair comparison, though, because some of these big players have very different goals, and mandates, than individual investors. Still, many of them take a long and expensive route, guided by active managers and consultants, to get to the same place they'd arrive at if they just listened to Warren.

The Buffett Special easily bests the average hedge fund return, as well. Below is a chart of VOO's index, SHY, and the Hedge Fund Research HFRI Fund Weighted Composite Index. (VOO itself isn't 10 years old, so the chart shows its underlying index.)

To be sure, most hedge funds aren't trying to beat the S&P 500. Instead, they're trying to provide a noncorrelated, risk-adjusted return stream. Regardless, they've struggled lately, and Buffett was really dinging them at the annual shareholders meeting this weekend for their high fees.As for the recommendation of 90 percent in a stock index fund, that might sound risky to some—but it shouldn't, Buffett says. Fear of price volatility can lead investors to do very risky things, such as taking money out of stocks and leaving it in cash after 2008, Buffett wrote in his shareholder letter about 2014 results:

If not for their fear of meaningless price volatility, these investors could have assured themselves of a good income for life by simply buying a very low-cost index fund whose dividends would trend upward over the years and whose principal would grow as well (with many ups and downs, to be sure).

It's hardly a sexy strategy. But as any Buffett follower knows, often the "boring" businesses produce the best results.

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Buffett Says Hedge Funds Are A Bad Deal For Investors *May 2, 2016* Trevor Hunnicutt | *Reuters*

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Warren Buffett nibbled on sweets during his presentation to shareholders on Saturday but he took a bite out of hedge fund managers. The storied stockpicker - speaking at a table festooned with Berkshire Hathaway Inc-owned See's Candies at the conglomerate's annual shareholder meeting - suggested that "supposedly sophisticated people" and institutions are being fleeced by hedge funds and their backers.

"There's been far, far, far more money made by people in Wall Street through salesmanship abilities than through investment abilities," Buffett said, citing a simple Vanguard Group index fund that tracks the S&P 500 index of large American companies. He said that fund has beat a group of costlier hedge funds over time. "Now that may sound like a terrible result for hedge funds, but it's not a terrible result for the hedge fund managers," Buffett said to laughter at the event held in Omaha.

During the financial crisis, Buffett bet the asset management company Protege Partners LLC $1 million that the S&P 500 will outperform a portfolio of hedge funds over the 10 years through 2017. Buffett said Saturday the index fund is beating the hedge funds by nearly 44 percentage points over 8 years.

Hedge funds are famous for their price tag - known as "two and 20" - a fee of two percent of the assets they manage each year and 20 percent of all gains.

It is not the first time Buffett has delivered the message. In his annual letter to shareholders two years ago, Buffett said he has ordered most of the money he is not giving away at his death to be placed in an index fund. "You just have to sit back and let American industry do its job for you," Buffett said.

Buffett said the cost of consulting and management fees, as well as commissions, eat up investment returns for the wealthy individuals, endowment funds and public pensions that use hedge funds.

New York City's largest public pension voted to exit all of its hedge fund investments earlier this month.

Vice Chairman Charlie Munger, who was seated next to Buffett, offered that some people who have given their savings to Berkshire and some other investors have done well. But, he said, finding such investors is "like looking for a needle in a haystack."

(Reporting by Trevor Hunnicutt; Editing Jennifer Ablan and Nick Zieminski)