

June 2011

Asset Class Returns

May 31, 2011 (YTD)

	YTD 2011	Last 10 yrs.*	2010	2009	2008
Bonds (%)					
One-year	0.6	3.1	1.2	1.9	4.0
Five-year	2.8	4.6	5.3	4.2	4.0
Intermediate	2.9	6.3	6.9	-0.7	12.9
Long-term	4.2	7.1	8.9	-12.1	22.5
U.S. stocks (%)					
Large Market	7.8	1.3	14.9	26.5	-37.0
Large Value	10.4	5.3	20.2	30.2	-40.8
Small Market	9.1	8.3	30.7	36.3	-36.0
Small Micro	7.8	9.6	31.3	28.1	-36.7
Small Value	6.7	11.1	30.9	33.6	-36.8
Real Estate	14.3	10.5	28.7	28.2	-37.4
International stocks (%)					
Large Market	6.7	3.9	9.3	30.6	-41.4
Large Value	6.3	7.8	10.6	39.5	-46.3
Small Market	6.1	11.7	23.9	42.0	-43.9
Small Value	6.3	13.5	18.1	39.5	-41.7
Emerg. Mkts.	2.6	15.6	21.8	71.8	-49.2

Descriptions of Indexes

One-Year bonds	DFA One-Year Fixed Income fund
Five-Year bonds	DFA Five-Year Global Fixed
Intermediate bonds	DFA Intermed. Gov't Bond fund
Long-term bonds	Vanguard Long-term U.S.Treas.
U.S. Large Market	DFA U.S. Large Co. fund
U.S. Large Value	DFA Large Cap Value fund
U.S. Small Market	DFA U.S. Small Cap fund
U.S. Small Micro	DFA U.S. Micro Cap fund
U.S. Small Value	DFA U.S. Small Value fund
Real Estate	DFA Real Estate Securities fund
Int'l Large Market	DFA Large Cap Int'l fund
Int'l Large Value	DFA Int'l Value fund
Int'l Small Market	DFA Int'l Small Company fund
Int'l Small Value	DFA Int'l Small Cap Value fund
Emerging Markets	DFA Emerging Markets fund

Last 10 yrs. returns are ended 12/31/10.

Equius Partners is an investment advisor registered with the Securities and Exchange Commission. Consider the investment objectives, risks, and charges and expenses of any mutual fund and read the prospectus carefully before investing. Indexes are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio.

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Alternatives, Economic Politics & the Corruption of Sound Principles

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Wall Street's in a quandary. Despite the fact that the stock market, as measured by the S&P 500, has almost doubled in value over the last two years, millions of investors continue to shun stocks. Many got out of the market near the bottom (mutual fund cash flows don't lie) and have never returned, while others look at the current economic malaise and have chosen to sit on cash or buy gold instead. Short-term performance isn't selling. So Wall Street is taking the fact that the U.S. stock market from 2001-2010 has only produced a 1.4% annual return and is using it to aggressively promote "alternatives." How ironic.

Trade publications, as well as articles in the mainstream press, bear witness to a trend of more and more advisors looking to "improve" their inherently flawed strategies with gold, commodity, hedge fund, and other "non-stock and bond" investments. Surprisingly, we even know of advisors who embrace the principles of passive asset class investing and are adding alternatives either as a result of industry and client pressure or because they're doing shoddy research and analysis.

The products of choice for alternatives are a slew of new mutual funds and ETFs designed for the retail market. Wall Street has effectively taken what was once the exclusive domain of the super wealthy (who have plenty of money to waste, and many have done so), introduced it "down market" with hefty fees, and convinced a bunch of naive advisors and their clients that this is a good thing. It is...for Wall Street.

Bowing to their Wall Street masters, while, as always, proclaiming the high ground is Morningstar, the popular mutual fund database firm. Morningstar's list of alternative investment categories is expanding rapidly (I count 15 so far) and will, as always, only include the survivors (winners) when the numbers are published—skewing the category performance averages upward. Besides continuing to legitimize active management in general with their inherently flawed star rating system (the most prominent victims of which are 401(k) participants), Morningstar has upped the ante by including these even more speculative funds.

So how have these new products done so far? Well, if we ignore the fact that only five of the 15 alternative categories in Morningstar (M*) have funds with track records going back 10 years, that there are only 50 unique funds within these categories with a 10-year record, and that these funds represent only those that have survived, not bad! Table 1 on the next page shows the results.

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Table 1: Returns 2001-2010	Total	Annual
M* Equity Precious Metals	793.3%	24.5%
M* Currency	55.8%	4.5%
M* Long/Short Equity	32.5%	2.9%
M* Market Neutral	25.5%	2.3%
S&P 500	15.1%	1.4%
M* Multi-alternative	-4.7%	-0.5%
M* Bear-Market	-58.6%	-8.4%

Yep, stocks in general sure stunk up the place. But the worst alternative strategy was the one where managers bet that stocks would stink up the place (Bear-Market). Go figure.

Now let's look at Equius Partners' chosen "alternatives" compared to this lineup.

Table 2: Returns 2001-2010	Total	Annual
M* Equity Precious Metals	793.3%	24.5%
DFA International Small Value	254.5%	13.5%
DFA U.S. Small Value	187.6%	11.1%
DFA International Value	111.2%	7.8%
DFA U.S. Large Value	67.6%	5.3%
DFA Five-Year Global Fixed	57.2%	4.6%
M* Currency	55.8%	4.5%
M* Long/Short Equity	32.5%	2.9%
M* Market Neutral	25.5%	2.3%
S&P 500	15.1%	1.4%
M* Multi-alternative	-4.7%	-0.5%
M* Bear-Market	-58.6%	-8.4%

Global *core* equity asset classes; high-quality, short-term fixed income; and very well structured and managed asset class funds appear to be an attractive alternative to alternatives, don't they? Of course, if we had abandoned our principles and ignored our research at the bottom of the market when stocks were seemingly toxic, the comparisons would be even more stark. But I'll stop here to avoid piling on.

Stocks and bonds are *the* core investments for long-term investors. Individual investors and financial advisors corrupt the basic risk/return principles associated with these investments through short-term speculation, over-concentration, harebrained strategies, and excessive costs. The market is messy and unpredictable. Investors and advisors should avoid making it more so.

Economic Politics

The debate concerning the role of the federal government in "steering" or "fixing" the U.S. economy has not been more heated, or more important, in my 30 years in the investment industry than it is today. Most advisors, us included, try to avoid politics like the plague because our clients run the gamut from the left to the right. But I'm extremely troubled not only by the massive growth of the government over the past decade or so and the financing burden this places on my children and grandchildren, as well as the negative impact it has on economic growth, but also by the expectations set by virtually every type and persuasion of the media that more government intervention in the economy is the answer.

Getting back to *core* principles, individuals and businesses create wealth and economic prosperity. The role of government, at least as designed by our founders and subsequently improved upon in obvious ways (civil rights most notably), is to create as level a playing field as possible, establish and enforce the rule of law, protect individual rights against the potential tyranny of self-appointed powerful elites in business and politics, provide security, and manage infrastructure projects that benefit the total population. As a society, we've also come to accept a role for government in assisting those who are *unable* to take care of themselves, alongside, of course, private charities and religious organizations.

Where government *almost always* goes wrong is in attempting to steer private capital against market forces, too often corrupting normal risk and return dynamics in the process.

I noted in a recent blog post on our website that this recession *is not* the worst since the Great Depression, despite the persistent narrative from the mainstream press. The 1980-1981 recession was. And if one looks at the steps our government took at that time to unleash the private sector and to restrain itself where it could most effectively—notably in the area of money supply and interest rates—and then looks at the results, the contrast with today couldn't be more stark. We can, and will, argue the details. But if we as a country would concentrate on the core principles behind economic growth in a free society and elect politicians on the left or right that understand them and seek to balance these with other social or ideological goals, we will all, in my humble opinion, be better off.

Past performance is no guarantee of future results. This information is for illustration purposes only and is not a recommendation of particular mutual funds or investment strategies. Source: Morningstar Principia mutual fund database and Dimensional Fund Advisors Returns program.