

Asset Class Returns

September 30, 2013

	YTD 2013	Past 10 yrs.*	2012	2011	2010
Bonds (%)					
One-Year	0.3	2.3	0.9	0.6	1.2
Five-Year	-0.3	4.0	4.8	4.5	5.3
Intermediate	-2.8	5.3	3.7	9.4	6.9
Long-Term	-9.8	7.4	3.5	29.3	8.9
U.S. stocks (%)					
Large Market	19.7	7.0	15.8	2.1	14.9
Large Value	24.9	8.4	22.1	-3.1	20.2
Small Market	28.9	10.9	18.4	-3.2	30.7
Small Micro	30.4	10.4	18.2	-3.3	31.3
Small Value	27.4	11.3	21.7	-7.6	30.9
Real Estate	2.5	11.4	17.5	9.0	28.7
International stocks (%)					
Large Market	14.2	8.4	17.8	-12.3	9.3
Large Value	16.1	10.2	16.6	-16.9	10.6
Small Market	19.4	12.8	18.9	-15.4	23.9
Small Value	22.8	13.5	22.3	-17.5	18.1
Emerg. Mkts.	-4.9	17.4	19.2	-17.4	21.8

All returns except "YTD" (Year to Date) are annualized.

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

"Past 10 yrs." returns are ended 12/31/12.

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.

Past performance is not a guarantee of future results.

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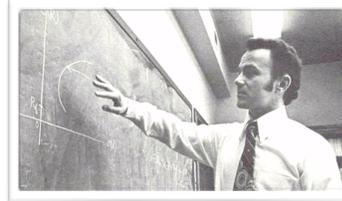
A Nobel Prize for the Rest of Us

Jeff Troutner, Equius Partners

Fifty years after Eugene F. Fama joined the University of Chicago faculty and thirty-three years after the publication of his article "Efficient Capital Markets: A Review of Theory and Empirical Work," the Royal Swedish Academy of Sciences has finally honored the good professor with a Nobel Prize.

Winning the Nobel Prize in Economics is obviously an enormous honor, and it is usually bestowed on a person who has contributed to his or her area of economic sciences in a very meaningful way over many years. (It also comes with a large cash award of about \$1.5 million.)

While I'm sure Professor Fama feels a great deal of personal pride and satisfaction in receiving the award for his research, I suspect that his greatest satisfaction comes in knowing how his work has resulted in considerably better investment outcomes for all the blue-collar workers, teachers, professionals, small-business owners, and other investors of modest means.



Fama's research inspired the creation of the first index fund, two of the largest mutual fund companies in the world (Dimensional Fund Advisors and The Vanguard Group), and the birth of thousands of independent investment advisors who apply his research for the

benefit of millions of individual investors. The success of Dimensional Fund Advisors also resulted in the \$300 million contribution by David Booth to the University of Chicago Graduate School of Business, which is now called the Booth School of Business.

Fama's work, along with that of his longtime research partner Ken French, has quite literally led to the retention and growth of billions of dollars for investors that otherwise would have flowed to old-school investment types promising, but rarely delivering (except by luck), the extra returns they so easily and unashamedly promote. With the help of advisors such as Equius, many of these investors have also avoided the most common behavioral mistakes that would likely have destroyed an even greater percentage of their hard-earned wealth.

Congratulations, Professor Fama! We and our clients thank you (and Ken French) for your contributions to the advancement of the science of investing and the outstanding real-world benefits we've realized as a result of your great work.

Anything But Passive: Investing and Marketing at Equius

Jeff Troutner, Equius Partners

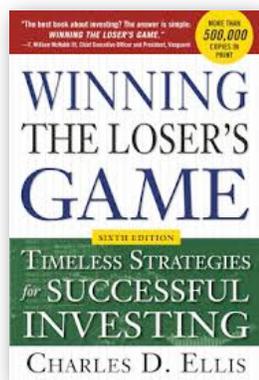
At a recent Equius event to celebrate the 20th anniversary of *Asset Class*, I spoke about the history of our firm and, in particular, its unusual marketing philosophy—one that can essentially be described as “build it and they will come.”

This philosophy was adopted on the belief, reinforced by experience, that trying to *convert* active investors into passive investors by *selling* the *positive* aspects of our approach was usually a waste of time.

We started in the mid-90s, after all. Imagine us telling an investor then: “Own nine thousand stocks (not twenty). Don’t overconcentrate in technology, biotech, and telecom. Think in terms of twenty years (not the past three or next one). Ignore traditional research on individual securities and all economic forecasts. Listen to the academics (and ignore Wall Street). Make few changes to your portfolio. Don’t sell when everyone else is selling, and don’t buy when everyone else is buying. Buy, hold, rebalance. Balance is good. Be unconventional.”

“Yeah, that’s the American Way! Tell that to Warren Buffett!” they would say. Not surprisingly, few would listen. No, *selling* was not an option. *Converting* was not an option. *Positive* spin was not an option. Charley Ellis’s approach, however, did work. In fact, it always has.

Winning the Loser’s Game



Ellis is one of the most prominent consultants to the investment industry through his firm, Greenwich Associates. He has written a highly influential book, *Winning the Loser’s Game*, in which he is very critical of conventional, old-school Wall Street (active management in general) and educates investors—professional and amateur alike—by pointing out

investment and behavioral *mistakes* that should be avoided.

Not very positive, right? Well, maybe not the message, but the results have been pretty

phenomenal. Over 500,000 copies of Ellis’s book are in print, and his insights—for those who sought them out—have improved the outcomes for millions of investors who adopted an indexed or asset class approach for their serious, long-term investments.

Inspired by Ellis, our marketing approach wasn’t as totally passive as “build it and they will come” implies. We’ve published 178 *Asset Class* articles over twenty years, launched one of the very first investment advisory websites, and founded a very popular general indexing website in our attempts to spread the word about the benefits of indexing and asset class investing.

We also have two apps for the Apple iPad: “Asset Class,” which delivers this newsletter electronically to anyone anywhere, and “Index Matrix,” which illustrates 85



years of asset class performance in one simple, interactive graphical display. Both are free to anyone at the iTunes store.

As a result of this “passive” approach to marketing, we remain one of a relative handful of new-school firms in our industry that investors actually *seek out* after their last turn on the active management merry-go-round. This means that more often than not, we end up picking up the pieces of portfolios that have either stagnated for years or are finally down 20%, 30%, or 40% or more before investors took proactive steps to find a smarter and more predictable way of growing investment assets while also maintaining their sanity.

We would rather encourage more investors to jump off the merry-go-round *before* a particularly bad investment experience, but that remains a major challenge for us. It might be similar to why some adventure sports enthusiasts tend to avoid a lot of their rehab after a crash or injury—that tedious, boring, but ultimately beneficial stuff gets in the way of the real excitement. It’s only when a career is threatened or mortality beckons that they get

Continued on page 3

serious about healing and staying healthy. (OK, I'm projecting, but still.)

We are seeing some progress in transitioning prospective clients to this approach *before* their portfolios are decimated, and it's coming primarily from the efforts of our current clients. For our clients, having survived both the dot-com debacle and the "Great Recession" in good shape has reminded them of past mistakes not repeated. And so they are quicker at recognizing mistakes friends or family members are making or *might* make in the future if they continue on the conventional course with all the broken promises and emotional stress that come with it. Introductions to our team and our approach are happening more frequently as a result. This trend is also consistent with industry trends that show more and more investors moving away from active management and into "passive" indexing and asset class strategies.

Our Challenge Areas

Still, certain areas of the market for investment services remain a major challenge for us. And these are areas in which one would logically expect asset class investing to be embraced enthusiastically. I will review some of these in future *Asset Class* articles by pointing out, per Ellis's approach, the most frequent mistakes and false assumptions these investors make that doom them to mediocre results and unnecessary stress and volatility.

At minimum, I'm hopeful that by recognizing mistakes they no longer make, Equus clients will become even more confident in their decision to adopt and maintain the behavioral and investment disciplines we promote. But we also hope to stimulate helpful conversations that result in more effective penetration in the challenging areas, especially where large numbers of individual investors will be positively affected (e.g., both defined benefit and defined contribution retirement plans).

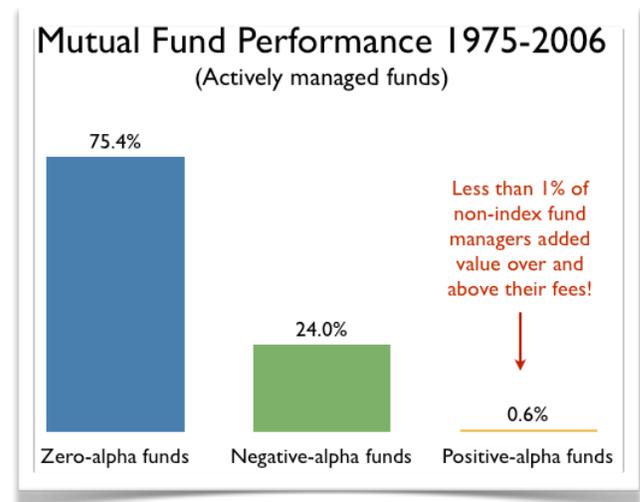
Positive and Negative Activities

As sort of a cheat sheet for upcoming articles (and just general reference), I've created Table 1 on the next page. It outlines the active steps we take in implementing our "passive" strategies (which add value) and the active steps conventional strategies implement (which destroy or transfer value away from investors).

To understand how eliminating these active mistakes can improve investment outcomes,

consider recent research by Laurent Barras, Olivier Scaillet, and Russ Wermers. Their paper "[False Discoveries in Mutual Fund Performance: Measuring Luck in Estimated Alphas](#)" looked at the performance of 2,076 active mutual funds from 1975 to 2006.

They found that managers of 75% of the funds exhibited stock-picking ability, but not enough to cover their fees (zero-alpha funds) and 24% were basically unskilled (negative-alpha funds). Incredibly, only 0.6% of the fund managers delivered returns to investors in excess of their fees (positive-alpha funds)!



As Charley Ellis has so elegantly and effectively shown us in six editions of *Winning the Loser's Game*, recognizing and eliminating common investment mistakes and false assumptions will almost certainly place you in the top 1% of all investors.

Equus Partners remains positively committed to identifying, discussing, and eliminating these mistakes for as many investors as possible.

Table 1: Major Differences in Active and “Passive” Strategies

The Yes and No indicate whether the activity is or is not part of the approach. **Red** text indicates a negative activity/feature and **green** text indicates a positive activity/feature.

Activity	Active Management	“Passive” Indexing	“Passive” Asset Class Investing
<p>Modern Research on Markets</p> <p>Review and <i>apply</i> the best and latest academic research on market efficiency, security pricing, and active management performance.</p>	<p>No</p> <p><i>Remains entrenched in 1930s-era Graham/Dodd research.</i></p>	<p>Yes</p> <p><i>Accepts that changes in markets and technology render active management impotent.</i></p>	<p>Yes</p> <p><i>Same as indexing.</i></p>
<p>Modern Research on Risk Factors</p> <p>Review and <i>apply</i> the best and latest academic research on risk and return, diversification, portfolio structure, and management at the asset class level.</p>	<p>No</p> <p><i>Almost all research is focused on individual security level.</i></p>	<p>No</p> <p><i>Almost all research is focused on total market level.</i></p>	<p>Yes</p> <p><i>Recognizes and applies the 1992 and subsequent factor research of Fama/French and others.</i></p>
<p>Modern Research on Behavior</p> <p>Review and <i>apply</i> the best academic research on investor behavior to eliminate common investor mistakes.</p>	<p>No</p> <p><i>Active investing actively elicits and fuels bad investor behavior.</i></p>	<p>No</p> <p><i>Indexing promotes stubborn individualism, leaving investors to fend for themselves.</i></p>	<p>Yes</p> <p><i>Actively counteracts the power of Wall Street marketing and human emotion that drive bad investor decisions.</i></p>
<p>Disciplined Risk Control</p> <p>Through disciplined rebalancing, maintains a consistent risk level for the portfolio, understanding that risk drives return.</p>	<p>No</p> <p><i>See “Destructive Behavior-Managers” below</i></p>	<p>No</p> <p><i>Less likely if investor-driven; discouraged by prominent expert.*</i></p>	<p>Yes</p> <p><i>Usually initiated by a disciplined advisor and typically includes effective counseling during extreme market cycles.</i></p>
<p>Sustainability</p> <p>Eliminates strategy/manager/portfolio volatility due to performance chasing or manager mortality that negatively impacts multigenerational transfers.</p>	<p>No</p> <p><i>See “Manager Changes: Firms/Investors” below.</i></p>	<p>Yes</p> <p><i>Implementation not dependent on mortal managers.</i></p>	<p>Yes</p> <p><i>Implementation not dependent on mortal managers. Firm sale/transfer could result in less commitment to discipline.</i></p>
<p>Stock Picking</p> <p>Results in overly concentrated positions in individual stocks and bonds based primarily on forecasts and predictions.</p>	<p>Yes</p>	<p>No</p> <p><i>Highly diversified market portfolios.</i></p>	<p>No</p> <p><i>Highly diversified and more balanced asset class portfolios.</i></p>
<p>Destructive Behavior-Managers</p> <p>Industry, sector, and market timing (increasing/decreasing exposure) based on forecasts, business metrics (i.e., preservation of asset base for fees, large asset base, etc.), and industry pressures.</p>	<p>Yes</p>	<p>No</p> <p><i>Strategies stay true to style, but may be prone to changes in underlying index.</i></p>	<p>No</p> <p><i>Strategies stay true to style through all cycles.</i></p>
<p>Destructive Behavior-Investors</p> <p>Industry, sector, and market timing (increasing/decreasing exposure) based on forecasts and emotion, mostly driven by industry and media pressures.</p>	<p>Yes</p>	<p>Yes</p> <p><i>Typically limited to the most destructive market timing moves, usually emotion-driven.</i></p>	<p>No</p> <p><i>Best advisors will not allow short-term changes in allocations due to forecasts or emotions.</i></p>
<p>Manager Changes: Firms</p> <p>Frequent internal changes in portfolio/fund managers due to growth (or lack thereof), bad performance, mergers and acquisitions, and death.</p>	<p>Yes</p>	<p>No</p> <p><i>Strategies not dependent on portfolio managers.</i></p>	<p>No</p> <p><i>Strategies not dependent on portfolio managers; structural improvements over indexing enhance expected returns.</i></p>
<p>Manager/Fund Changes: Investors</p> <p>Frequent investor changes in managers/funds based on short-term performance.</p>	<p>Yes</p>	<p>No</p> <p><i>Very stable mutual fund portfolios.</i></p>	<p>No</p> <p><i>Very stable mutual fund portfolios.</i></p>

*John Bogle, the former chairman of The Vanguard Group, recently [stated](#): “If you can ignore market fluctuations along the way, *it’s better not to rebalance*, since you’re likely to get higher returns.” (My emphasis.) It’s hard to imagine a more irresponsible statement to make to generally unsophisticated do-it-yourself investors. “St. Jack” is once again setting up investors for failure, as his “total market is the only way to go” advice has done since at least 2000.