

June 2014

## Asset Class Returns

May 31, 2014

	YTD 2014	2013	2012	2011	Past 10 yrs.*
<b>Bonds (%)</b>					
One-Year	0.3	0.3	0.9	0.6	2.2
Five-Year	2.1	-0.4	4.8	4.5	3.6
Intermediate	3.4	-3.5	3.7	9.4	4.7
Long-Term	10.6	-11.4	3.3	28.2	6.1
<b>U.S. stocks (%)</b>					
Large Market	4.9	32.3	15.8	2.1	7.4
Large Value	4.5	40.3	22.1	-3.1	8.9
Small Market	-1.6	42.2	18.4	-3.2	10.2
Small Micro	-2.8	45.1	18.2	-3.3	9.3
Small Value	0.1	42.4	21.7	-7.6	10.0
Real Estate	16.9	1.4	17.5	9.0	8.2
<b>International stocks (%)</b>					
Large Market	4.0	20.7	17.8	-12.3	7.0
Large Value	3.9	23.1	16.6	-16.9	8.1
Small Market	5.0	27.4	18.9	-15.4	10.3
Small Value	6.5	32.4	22.3	-17.5	10.9
Emerg. Mkts.	3.7	-3.1	19.2	-17.4	11.6

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	Long-term Gov't Bond Index
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 12/31/13.

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 Better Buffett

Jeff Troutner, Equius Partners

I have been fascinated with Warren Buffett for as long as I can remember. Through him, I was introduced to his teacher and mentor, Ben Graham. There are aspects of Buffett's life and his investment philosophy (value investing) that appealed to me at an early age and have clearly influenced my approach to long-term investing. Understandably, as financial markets and the science of investing have evolved, so have my views. Today it's safe to say Graham's wisdom remains a major influence on me, while Buffett's influence has waned.

Berkshire Hathaway is Buffett's primary investment vehicle. The company held its annual meeting recently, and as usual, Buffett was the center of the financial media's attention over a good month or so. Given all this attention, I thought it would be interesting to compare Berkshire's performance over the past 14 years to a more *evolved* approach to value investing, note some comments from Ben Graham just prior to his death in 1976, and compare Graham's comments with some of Buffett's in his recent annual letter to shareholders.

### Performance

Berkshire outperformed the market index by over 5% per year during one of the most volatile periods in stock market history. Most investors would attribute this success to Buffett's value-stock-picking prowess. But note how two of the oldest and most well-regarded value *index* funds performed over the same period. Portfolio mixes that include the S&P 500 and international value stocks also did well relative to Berkshire, with much greater diversification and without the "guru risk" associated with the Berkshire stock (Buffett is, after all, mortal).

Investment Option: 2000-2013	Annual Return	Total Return	# of Stocks
S&P 500 Index	3.6%	64.0%	500
Berkshire Hathaway stock (BRK-A)	8.8%	224.6%	1*
DFA US Large Cap Value fund (DFLVX)	8.3%	206.4%	241
DFA US Small Cap Value fund (DFSVM)	12.2%	402.4%	1,278
Equius All-U.S. Value portfolio	10.0%	277.4%	1,519
Equius U.S.-only portfolio	8.6%	217.9%	2,022*
Equius Global portfolio	8.8%	224.7%	4,703*

\*Berkshire owns positions in over 40 publicly traded stocks and owns numerous other businesses. See description of data in footnotes.

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Dimensional Fund Advisors (DFA) screens stocks for inclusion in their index funds (which are more appropriately considered “asset class” funds) using a methodology that is actually more objective than the process used by Standard and Poor’s (S&P) to include stocks for their indexes. In contrast to the S&P 500 index, which uses only size, Dimensional uses three criteria: size, relative price (value), and “direct profitability,” a new factor recently developed by Dimensional along with respected academics Eugene Fama and Ken French.

### **Ben Graham and Warren Buffett**

This is a much more evolved and modern approach to value investing than the more subjective, far less diversified stock-picking methods introduced by Ben Graham in the 1930s and followed in various forms today by most investment advisors and mutual fund managers. Dimensional’s approach is also consistent with research on market efficiency for which Fama recently won the Nobel Prize.

Most investors are unaware that this modern approach to value investing aligns very closely with what Graham came to believe just prior to his death. In an interview with the *Financial Analysts Journal* in 1976, Graham stated the following (the full interview can be found online [here](#)):

*FAJ:* In selecting the common stock portfolio, do you advise careful study of and selectivity among different issues?

*Graham:* In general, no. I am no longer an advocate of elaborate techniques of security analysis in order to find superior value opportunities. This was a rewarding activity, say, 40 years ago...but the situation has changed a great deal since then. ...In the light of the enormous amount of research now being carried on, I doubt whether in most cases such extensive efforts will generate sufficiently superior selections to justify their cost. To that very limited extent I’m on the side of the “efficient market” school of thought...

*FAJ:* What general approach to portfolio formation do you advocate?

*Graham:* Essentially, a highly simplified one that applies a single criteria or perhaps two criteria to the price...and that relies for its results on the performance of the portfolio as a whole—i.e., on the group results—rather than on the expectations for individual issues.

This is what Equius not only *advocates* but puts into practice every day (and has for the last 20 years). We subscribe to the efficient market school of thought by investing in structured asset class funds and index funds that diversify globally

among thousands of individual stocks—with a pronounced tilt to value stocks. Performance is *always* considered on the portfolio as a whole.

And Buffett? After many pages in this year’s Berkshire annual report devoted to convincing shareholders they’ll remain in good stock-picking hands after he dies, he made the following statement about bequeathed personal assets:

One bequest provides that cash will be delivered to a trustee for my wife’s benefit. ...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 suggest Vanguard’s.) I believe the trust’s long-term results from this policy will be superior to those attained by most investors—whether pension funds, institutions or individuals—who employ high-fee managers.\*

Putting aside the ethically confused fact that he treats Berkshire shareholders differently than his family, he also apparently has given up on value investing (the S&P 500 being growth-stock heavy).

### **The New Value Investing**

Ben Graham remained an advocate of value investing until he died. I’m not sure where Buffett stands (given his S&P 500 advice). Maybe he believes that “real” value investing will die with him. If he does, he’s wrong. Eugene Fama, Ken French, Dimensional Fund Advisors, and Equius Partners—after over 20 years of successful application—represent the new breed of *modern* value investors.

Simply put, modern value investing offers broader diversification, lower costs, greater style consistency and more predictable outcomes than guru-based stock-picking strategies.

Nobel Prize-winning academics and a new breed of index fund managers provide the tools, and the professionals at Equius Partners offer the knowledge, confidence, discipline, and personal touch to help clients navigate volatile markets with a globally diversified value approach.

I think Ben Graham would be proud that his legacy survives and thrives in the hands of a new generation of dedicated value investors.

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*\*Berkshire 2013 annual letter to shareholders.*

*Equius All-US Value portfolio is 60% DFLVX, 40% DFSVX. Equius U.S.-only portfolio is 30% DFA US Large Company fund (DFUSX), 30% DFLVX, and 40% DFSVX. Equius Global portfolio is 21% DFUSX, 21% DFLVX, 28% DFSVX, 18% DFA Int’l Value fund (DFIVX), and 12% DFA Int’l Small Value fund (DISVX). Past performance is no guarantee of future returns. Data is for informational purposes only and should not be construed as personal investment advice.*