

Asset Class Returns

November 30, 2015

	YTD 2015	2014	2013	2012	Past 10 yrs.*
Bonds (%)					
One-Year	0.4	0.3	0.3	0.9	2.1
Five-Year	1.8	2.9	-0.4	4.8	3.6
Intermediate	2.1	5.2	-3.5	3.7	4.8
Long-Term	0.1	23.9	-11.4	3.3	7.5
U.S. stocks (%)					
Large Market	3.0	13.5	32.3	15.8	7.7
Large Value	-0.4	10.1	40.3	22.1	8.1
Small Market	2.2	4.4	42.2	18.4	8.8
Small Micro	1.4	2.9	45.1	18.2	7.8
Small Value	-1.7	3.5	42.4	21.7	7.9
Real Estate	1.3	31.1	1.4	17.5	8.1
International stocks (%)					
Large Market	-0.6	-5.2	20.7	17.8	4.6
Large Value	-3.2	-7.0	23.1	16.6	4.6
Small Market	5.8	-6.3	27.4	18.9	6.7
Small Value	4.4	-5.0	32.4	22.3	7.1
Emerg. Mkts.	-13.4	-1.7	-3.1	19.2	8.6

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 US Large Company fund
U.S. Large Value	DFA US Large Cap Value fund
U.S. Small Market	DFA US Small Cap fund
U.S. Small Micro	DFA US Micro Cap fund
U.S. Small Value	DFA US 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 12/31/14.

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Past performance is not a guarantee of future results.

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Expectations

Jeff Troutner, Equius Partners

The way things are shaping up, it looks like 2015 will produce a second year in a row of mediocre investment results for our asset class investing strategy. We expect cycles like these as an acceptable cost of a long-term strategy that rewards patience and discipline with a much greater certainty of desired outcomes. There are alternatives, of course.

We could try to predict market movements, interest rate changes, or economic growth rates and hope to avoid these periods of low returns by making "tactical" shifts. But one look at our "[Yearly Returns Are Random](#)" article should dissuade you from such a silly notion.*

Or we could reject the science behind efficient markets and asset class risk/return and bet on gurus. This is what advisors who invested client assets in Third Avenue Management's Focused Credit fund did. This was a junk bond fund on steroids. I say "was" because Third Avenue Management recently announced that it is liquidating the fund and, to add insult to injury, restricting access to the shareholders' money as the firm attempts to sell the junk in the portfolio. This particular example is important to Equius clients for several reasons.

First, the fund was launched *only six years ago* by famed "value" investor Martin Whitman. Unlike Dimensional's Five-Year Global Fixed Income fund (our core bond fund, which was introduced in 1990), the investment strategy of the Focused Credit fund was *not* based on academic studies of the historical risk/return characteristics of bonds as they relate to term (maturity) and quality.

Second, the research behind the Dimensional fund was provided by Eugene Fama at the University of Chicago. After Fama won the Nobel Prize in 2013 for his work on efficient market theory, the 90-year-old Mr. Whitman wrote a [scathing letter to his funds' shareholders](#) calling Fama's work "utter nonsense," "sloppy science," "stupid," and "unscholarly."

Mr. Whitman's fund was hot and his hubris was off the charts. From its birth in September 2009 through June 2014, the fund was up 79% (12.8% per year) and assets grew to over \$3 billion. During this same period, the Dimensional fund was up just over 18% (3.5% per year).

An inevitable outcome of extreme subjectivity, over-concentration, and reliance on personal predictions and forecasts—all driven by an out-of-control ego—is disaster. Since June 2014, the value of the Focused Credit fund has fallen by over 40%. Its liquidation virtually ensures

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that the original shareholders will not recoup their investment. Worse, since most shareholders of the fund came in after its performance peaked, the bulk of the fund's investors will be lucky to recoup *half* of their investment. In contrast, the value of the Dimensional fund rose over the same period, despite rising interest rates on bonds with maturities of five years or less.

This is why we keep the fixed-income portion of balanced portfolios in high-quality, short-term bonds. We and our clients would rather take the bulk of portfolio risk on the equity side. And, call us crazy, but we're far more comfortable investing based on Fama's (and others') sound science on efficient markets and asset class risk/return than we are betting our clients' hard-earned wealth on old-school gurus and their massive egos.

Rational Expectations

Table 1 is a snapshot of what we observed going into 1995 when we had access to *all* of the large and small value stock funds through Dimensional and Vanguard. What you don't see is the research behind the numbers. These are the risk premiums (1.2% and 3.4%) we observed at the time.

Now look at Table 2 and notice how the index returns and risk premiums have changed very little from the first period. No, we didn't expect *that* kind of precision for the next 20 years. Heck, given all the pushback we faced for the first seven years of our firm's existence when the S&P 500 (large growth stocks) was on a historic tear, I wasn't even sure if we'd be in business in 20 years! But we did expect *risk premiums* for small cap and value stocks to eventually prevail. We were right.

	Annual Return	Risk Premium
S&P 500	9.8%	-
DFA US Large Cap Value Index	11.0%	1.2%
DFA US Small Cap Value Index	13.2%	3.4%

	Annual Return	Risk Premium
S&P 500	9.6%	-
DFA US Large Cap Value Index	11.0%	1.4%
DFA US Small Cap Value Index	14.0%	4.4%

	Annual Return	Risk Premium
S&P 500	9.8%	-
DFA US Large Cap Value Index	11.0%	1.2%
DFA US Small Cap Value Index	13.4%	3.6%

Our confidence in asset class investing and tilting client portfolios toward small cap and value stocks was derived from a combination of Fama's exceptional research and my personal experience evaluating and recommending the Martin Whitmans of the investing world during the first phase of my career. I've seen more Whitmans crash and burn than I can count. Whitman, like so many others, made millions for himself gambling his clients' money away on nothing but his "talent" at reading corporate financial statements. Too many advisors do the same, betting on the talents of these gurus.

The Focus Credit fund blowup is making headlines today, but investors should also know that since the inception of Dimensional's US Large Cap Value fund in March 1993, Whitman's Third Avenue Value has underperformed it by 136% in total return (0.82% annually) through November. His Third Avenue Small Cap Value fund has underperformed the DFA US Small Cap Value fund by 247% (2.6% annually) since the Third Avenue fund was launched in May 1997. Since the Third Avenue International Value fund was launched in January 2002, it's trailed the DFA International Value and DFA International Small Cap Value funds by 19% (0.56% annually) and 244% (5.4% annually), respectively. And he calls Fama *stupid*? Unbelievable.

Now let's put the past two years in perspective. Returns since the March 2009 have been *outstanding*, which is what we *expect* after significant market drop (see the [February 2009 Asset Class](#)), but *not* what we expect over longer periods. Table 4 breaks the period into two parts.

Conclusion? U.S. and international value stocks have lagged the S&P 500 for almost two years. We expect that. We also expect it to be temporary.

	3/2009 to 12/2013	1/2014 to 11/2015
DFA US Large Co. (S&P 500)	23.6%	8.5%
DFA US Large Cap Value	29.0%	4.9%
DFA US Small Cap Value	31.4%	0.9%
DFA International Value	20.2%	-5.3%
DFA Int'l Small Cap Value	22.8%	-0.4%

*See *Asset Class*, December 2014.

Indices are not available for direct investment. Fund returns are net of mutual fund expenses but do not reflect the deduction of advisory fees. This information is for illustration purposes only and should not be considered personal investment advice. Past performance does not guarantee future returns.