EQUIUS PARTNERS
Adding Balance to Wealth℠

ASSET CLASS℠

An update of performance, trends, research, & topics for long-term investors

Asset Class Returns

July 31, 2008 (YTD)

	2005	2006	2007	Last 10 yrs.	YTD 2008
Bonds (%)					
One-year	2.3	4.8	5.2	4.1	1.5
Five-Year	1.7	3.9	5.2	5.1	0.3
Intermediate	1.6	3.6	9.5	6.4	1.7
Long-term	6.6	1.7	9.2	7.0	-0.3
U.S. stocks (%)					
Large Market	4.9	15.7	5.4	5.8	-11.9
Large Value	10.2	20.2	-2.8	8.9	-10.6
Small Market	6.1	16.6	-3.1	9.0	-11.0
Small Micro	5.7	16.2	-5.2	10.6	-13.4
Small Value	7.8	21.5	-10.8	11.5	-10.4
Real Estate	13.2	35.3	-18.7	10.8	-3.4
International stocks (%)					
Large Market	13.5	24.9	12.5	8.6	-9.0
Large Value	15.3	34.1	10.2	13.0	-13.6
Small Market	22.0	24.9	5.6	14.3	-7.9
Small Value	23.2	28.4	3.0	16.2	-8.6
Emerg. Mkts.	29.9	29.2	36.0	16.0	-11.8

Descriptions of Indexes

Short-term 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 US Large Co. fund
U.S. Large Value	DFA Large Cap Value fund
U.S. Small Micro	DFA US Micro Cap fund
U.S. Small Market	DFA US Small 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

"Last 10 yrs." returns are ended 12/31/07.

Equius Partners, Inc. 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. **Past performance is not a guarantee of future results.**

Equius Partners, Inc.
4 Hamilton Landing, Suite 205
Novato, CA 94949
Phone: 415-382-2500
Fax: 415-382-2005

Editor: Jeffrey C. Troutner
jeff@equiuspartners.com

© 2008 Equius Partners, Inc.

August 2008

Is It Different This Time?

Jeff Troutner, Equius Partners

As stock prices have slumped around the world over the past year, investors have been confronted with a barrage of grim news—falling home prices, rising costs for food and fuel, and worries over the fragile health of the banking system. Some have concluded that the current state of affairs bears little resemblance to the past and are questioning the wisdom of maintaining consistent exposure to equities at all.

We don't know what the future for this business cycle looks like, but we do know that on many occasions in the past, investors were confronted with "unprecedented" events that tested their willingness to maintain a diversified approach. Some examples:

> **"On Wall Street, the most unnerving stock market reports since the Depression 1930s became daily more dismal."**
> *Time*, "The Economy: Crisis of Confidence," June 1, 1970.

> **"Fed up with rising food prices, thousands of women took to the streets in protest. . . . [President Nixon] announced that ceilings were being imposed on prices of beef, pork and lamb."**
> *Time*, "Changing Farm Policy to Cut Food Prices," April 9, 1973.

> **"The only way that the US can scrape through the next several years without major economic and social disruptions is to ease off dramatically on energy consumption."**
> *Time*, "The Arabs' New Oil Squeeze: Dimouts, Slowdowns, Chills," November 19, 1973.

> **"There have been multiplying signs that the long American romance with the big car may finally be ending. . . . Economists generally are agreed that the era of readily abundant fuel has ended for good."**
> *Time*, "The Painful Change to Thinking Small," December 31, 1973.

> **"Investors have been frightened of an economy that seems out of control. . . . The stock market has scarcely been so shaky since 1929. . . . A Gallup poll published last month found that 46% of adults feared a depression similar to the classic one of the 1930s."**
> *Time*, "Seeking Relief from a Massive Migraine," September 9, 1974.

> **"The woes of inflation and stagnation have touched nearly every American, but while some people are only slightly bruised, others feel as if they have gone ten rounds with George Foreman and are down for the count. . . . Pawnbrokers are gaining from once affluent people who have lost their jobs and are trying to get anything that they can out of jewelry or expensive cameras or appliances."**
> *Time*, "Who Is Hurting and Who Is Not," October 14, 1974.

> **"Financial markets at home and abroad have been devastated in recent weeks as frantic traders and investors scrambled to come to grips with the**

Continued on page 2

anti-inflation policies of the Carter Administration and the Federal Reserve Board. . . . After a nervous September, Wall Street succumbed to despair, and the stock market was bloodied by what is being called the October massacre."

John M. Lee, "Tumult in the Markets," *New York Times*, November 6, 1978.

"Fortunes were conjured out of thin air by fresh-faced traders who created nothing more than paper."

Walter Isaacson, "After the Fall," *Time*, November 2, 1987.

"The next recession won't look like any that has preceded it in recent decades. . . . We are so heavily indebted that a slump would quickly turn into a Latin American-style depression."

Ashby Bladen, "Borrowing to the Bitter End," *Forbes*, September 4, 1989.

"Chase Manhattan, the second largest US bank, is letting go 5,000 employees, or 12% of its work force, in a struggle to remain solvent. . . . The construction industry has creaked to a virtual halt after a decade of overbuilding. . . . From stock markets to supermarkets, high anxiety rules the day. . . . Now the specter of war, rapacious oil prices, and a far-reaching recession haunts political and business leaders everywhere. . . . The banks are basically pushing panic buttons everywhere."

"I want to say we're in a recession, but that's not a strong enough word. In some regions, it's a depression."

John Greenwald, "All Shook Up," *Time*, October 15, 1990. Final quotation attributed to William Hensler, chief executive, Wickes Lumber.

"Imagine every office building in Manhattan empty, a commercial ghost town. Now double it. That's how much vacant office space—500 million square feet—there is in the United States today. Behind much of that empty office space stands the nation's banking system. . . . The worry today is that the real estate recession, which is spreading nationally, could severely weaken the banking system, pulling down many smaller banks and a few big ones as well. . . . 'Our real estate market is as bad as we've had since the 1930s,' said Leo Spang, a Boston banker and president of the Real Estate Finance Association, a trade group."

Steve Lohr, "Banking's Real Estate Miseries," *New York Times*, January 13, 1991.

"Falling real estate prices and the fragile state of the banking system make this recession unlike any other and extremely difficult to forecast."

John R. Dorfman, "First Boston's Bear, Carmine Grigoli, Refuses to Stop Growling Despite Stocks' Big Rally," *Wall Street Journal*, February 7, 1991. Quotation attributed to Carmine Grigoli, chief investment strategist, First Boston Corp.

"The nation's top auditor said today that many more banks were effectively bankrupt than regulators had recognized. . . . 'The bank insurance fund is nearly insolvent, and I cannot overemphasize how important it is to restore it as quickly as possible,' Mr. Bowsher [Comptroller General] told the Senate Banking Committee."

Stephen Labaton, "Bank Deposit Fund Nearly Insolvent, US Auditor Says," *New York Times*, April 27, 1991.

"We're going into one of those long periods where the market does nothing except consolidate this huge move up we've had. Dow 4000 is going to be with us for a long time."

Daniel Kadlec, "Will Weary Legs End 20-Year Bull Ride?" *USA Today*, December 6, 1994. Quotation attributed to Seth Glickenhaus, senior partner, Glickenhaus & Co.

"This economic convulsion is unprecedented in the post-World War II era."

Robert J. Samuelson, "A World Meltdown?" *Newsweek* September 7, 1998

"This time it is different. This time the market won't be so quick to bounce back. . . . Who can look at the world right now and not conclude that things have changed dramatically?"

Joseph Nocera, "Requiem for the Bull," *Fortune*, September 28, 1998.

"Wall Street stocks have plunged—Merrill Lynch down 59%, Morgan Stanley down 59%, and Lehman Brothers down 67%. . . . The real problem is with the risks that are unquantifiable."

Bethany McLean, "Can the Brokerage Stocks Come Back?" *Fortune*, October 26, 1998.

"Investor nervousness pushed stock prices lower yesterday and sent signals of distress through the corporate bond market. . . . Many companies are overloaded with debt at a time of slowing economic growth. Among the stocks leading the decline yesterday were those of companies sensitive to the business cycle. . . . A Morgan Stanley index of 30 of these stocks plunged 4.7 percent yesterday, reflecting the worry that the economy may be headed for another recession."

Jonathan Fuerbringer, "Negative News from Some Blue Chips Takes Heavy Toll," *New York Times*, October 10, 2002. [Note: major US stock market indexes registered multi-year lows on October 9, 2002.]

The recent volatility in the markets is to be expected and *desired*, since we cannot rationally expect a long-term risk premium (returns in excess of risk-less securities) in stocks without it. Markets react to new information, but in patterns that are random and unpredictable. How many investors anticipated that 2003 would be the 14th best market year in 81 years after the 5th worst the year before?

Equity markets reward patient investors and humble the rest.

The Real Shame About Fannie & Freddie

John Tamny, Editor, RealClearMarkets.com

Credit given by dealers to unproductive consumers is never an addition, but always a detriment, to the sources of public wealth.—John Stuart Mill, *Principles of Political Economy*

Solvency questions at government-sponsored mortgage firms Fannie Mae and Freddie Mac have roiled the markets in recent weeks. Due to the massive exposure banks and financial institutions the world over have to the formerly safe shares issued by the mortgage giants, there has existed the fear that Fannie and Freddie's federal minders would "nationalize" them a la Bear Stearns with equity holders left holding very little. The debt issued by both was never really a question, and sure enough the government's implicit backing was made explicit as expected.

For the above alone, Fannie and Freddie's problems are a major shame. Thanks to the guarantees that are part and parcel of institutions chartered by the federal government, they were able to overextend themselves in the mortgage market, and in the process they've helped discredit capitalism. Even though their activities had nothing to do with true capitalism, this hasn't kept the E.J. Dionne's of the world from proclaiming that today's problems are rooted in too much economic freedom, as opposed to the reality that capitalism today is increasingly of the big-government variety.

But the bigger shame when it comes to Fannie and Freddie involves the longer-term economic harm that results from too much capital flowing into the ground. Founded to increase mortgage-market liquidity in the U.S., Fannie and then Freddie were supposed to foster greater "community" in the United States given the broadly held view that homeowners are better, more invested citizens. If we ignore the extra-Constitutional nature of such government activity, not to mention that equity holdings presumably "invest" us just as much in the U.S., we can then address the problems that result from government doing what it should not.

On the capital front, even though anyone with a pulse always knew that taxpayers would be on the hook if problems arose at Fannie and Freddie, their bonds were always a great investment for offering more yield than government-backed Treasuries of the same maturity. Thanks to their presumed government guarantee, Fannie and Freddie bonds have logically attracted far more investment than they would have in a free economy.

The above was and is problematic considering that we live in a world of limited capital. Fannie and Freddie themselves pull in a great deal of investment, plus private banks have greater incentives to make loans in the housing space with full knowledge that our government-sponsored institutions will be there to provide massive liquidity in the secondary mortgage market.

Taking nothing away from the necessity that is shelter, the extra subsidies have given us an unseen economic retardant. Indeed, when subsidies drive increased capital flows to certain sectors, others go wanting. What will never be known is how many Microsofts and Googles were strangled at infancy due to capital that was consumed in the housing market as opposed to making its way to job-creating businesses and entrepreneurs.

Simply put, subsidies distort investment flows, and with housing a heavily subsidized sector, capital that might have found its way to entrepreneurs in an economy not muddled by government intrusion found its way to the unproductive sector that is housing. When John Stuart Mill wrote about unproductive consumption, housing was at or near the top of his list.

Sadly, the story gets worse. With U.S. residential property worth just south of $21 trillion (easily exceeding the total stock-market worth of all public companies) as of last year thanks to land-

Continued on page 4

use rules, its preferred status among our leaders in Washington, and the ever weakening dollar, it is increasingly the main source of wealth for most households. This is problematic from an asset diversification standpoint, particularly during times of housing uncertainty, but it's most enervating for keeping many Americans stationary in an economy that is not.

Sure enough, with some Americans logically reluctant or unable to unload what might be their best investment, many feel the need to stay in one place despite the fact that capital moves at lightning speed, and with very little regard for the past residential choices of most Americans. No doubt many residents of Michigan and Ohio would like to move where economic opportunity is greater, but home ownership has become the proverbial ball-and-chain that makes following capital and opportunities difficult.

So not only is the housing subsidy that Fannie and Freddie represent unfortunate for distorting capital flows, it's probably most harmful for discouraging the more robust migratory patterns that would enable our economy to grow in the most optimal way. Indeed, that Fannie and Freddie are effectively insolvent is almost beside the point. We should expect that from institutions whose successes are private, but whose losses are shared by the public.

Going forward, once the bailout of what's been a government-created mistake is complete, Fannie and Freddie should be sold in order to shed any ties to the federal behemoth that created them. Additionally, the subsidies that are mortgage-interest deductions and tax-free sales should be normalized so as to make them no more enticing than that offered by equity investment.

As for our political class, here's hoping the bi-partisan and politically correct notion suggesting everyone should own a home goes the way of Prohibition, "stimulus" and other bad ideas foisted on us by Washington throughout history. While housing is an essential good, government efforts to make ownership universal have redirected money away from the productive economy, all the while slowing the necessary movement of human capital in a world of fast-moving financial capital.

John Tamny is editor of RealClearMarkets, a senior economist with H.C. Wainwright Economics, and a senior economic advisor to Toreador Research and Trading. Reprinted by permission. He can be reached at jtamny@realclearmarkets.com.

A New Addition to the Equius Family

Born June 20, 2008, Aiden Jeffrey Calagui is the newest member of the Equius Family. Aiden is the first child of Katie Calagui, our Director of Corporate Strategies, and Jeff Troutner's first grandchild.

Jeff, Phil and the rest of the Equius Team want to congratulate Katie and husband Bob on bringing little Aiden into our world and we all look forward to having Katie back from her maternity leave.

We also look forward to breaking in the new Equius day-care center outside Phil and Jeff's office doors. So if you hear little Aiden's voice in the background, remember: *we're adding balance to wealth*.