

TAM ASSET MANAGEMENT REVIEW

Modern Investment Principles
For Serious Investors

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Investors and Smokers








By Jeff Troutner

Investors who use actively-managed mutual funds (non-index funds) or active money managers have an addiction similar to cigarette smokers. Like smokers, they have an emotional or psychological attachment to something that is harmful to them over the long-term. There is one major difference, however. Most smokers, with the possible exception of the young and uneducated, *know* the health risks associated with smoking. Most investors, either because they have not taken the time to learn or they rely totally on the advice of a broker or active manager, are unaware of the risks and costs of active management and the significant odds against maintaining a healthy portfolio over the long-term using active strategies.

Like smoking, there are many unhealthy side effects to active management. Yet, despite these—the revolving door of manager replacements, frequent switches among mutual funds, pushy brokers, sales loads, high commissions, fat fees, bigger ups and downs, less diversification, etc.—investors keep smoking away.

The active-management addiction also cuts across all economic and educational lines. For example, corporate retirement plan sponsors and municipal administrators, an educated lot for the most part, change brands occasionally (often changing to the low tar and nicotine model after major market declines) and sometimes cut back by adding the token S&P 500 index fund. Yet, they seldom kick the habit altogether without a major struggle. Some dig them-

Continued on next page...

Asset Class Returns* Through February 28, 1995		
	United States	YTD 1995
	1-Yr. Bonds	+1.9%
	5-Yr. Bonds	+2.2%
	Large Stocks	+6.6%
	Large Value Stocks	+8.1%
	Small Stocks	+5.4%
	Small Value Stocks	+4.5%
	International	
	Large Stocks	-4.4%
	Large Value Stocks	-4.2%
	Japan	
	Small Stocks	-9.8%
	Continental Europe	
	Small Stocks	+1.2%
	United Kingdom	
	Small Stocks	-1.9%
	Pacific Rim	
	Small Stocks	-7.4%
	Emerging Markets	
	Stocks	-9.8%

The U.S. continues to outperform the international markets, but with dividend yields near historic lows, this could change very fast.

*See "Performance Notes" on back page for explanations.

TAM Portfolio Returns Net of Fees* Through February 28, 1995				
	Year-to-Date			Since Inception
Risk (% stocks)	1995	1994	1993	12/92-2/95
Aggressive (95%)	-0.7%	+5.3%	+21.1%	+26.6%
Growth (85%)	+0.3%	+2.6%	+16.6%	+19.9%
Moderate (65%)	+1.0%	+2.1%	+14.0%	+17.5%
Benchmarks				
Balanced Fund Index	+4.2%	-2.2%	+11.7%	+13.8%
Capital Apprec. Index	+4.2%	-2.5%	+14.8%	+16.7%
S&P 500 Stock Index	+6.6%	+1.3%	+10.1%	+18.8%
Salomon Broad Bond Index	+4.5%	-2.8%	+9.9%	+11.5%

*See "Performance Notes" on back page for explanations.

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selves in deeper by going to a “multiple-manager” approach (from one pack a day to three or four).

Small business owners and professionals, such as physicians and dentists, tend to be “chain-smokers” when it comes to broker-marketed investment products. Most have gone through more advisors, mutual funds, and “tax-advantaged” investments than any other group of investors I can think of. Why is this?

One reason might be that medical professionals, for example, view most purveyors of investment advice as “professionals” and expect to be treated the same way he or she would treat a patient. Are brokers and investment managers true professionals? According to my dictionary, a profession is defined as “an occupation or vocation *requiring* training in the liberal arts or the sciences and *advanced* study in a specialized field” (italics added).

Most brokers are trained only in the art of *selling*. Many do not have a college degree and many others do not possess a degree in finance, economics, accounting, or investments. The same is true of many independent money managers.

Most investment people must pass a fairly simple exam to be registered, but this is no substitute for advanced training in what has increasingly become the science of investment management.

Investors must realize that not only are many brokers and advisors *not familiar* with the science of modern portfolio theory and the benefits of indexing, but most are *unable to offer* an indexed strategy because of constraints put on them by their firms. Many others see active management as a cash cow that they cannot give up. Finally, many view traditional active strategies as an “easy sell” since most people buy what everyone else is buying. On Wall Street, this “herd effect” is particularly powerful (and profitable).

As smokers should not go to the tobacco companies for information on the health consequences of smoking, investors should not go to stockbrokers or active managers for advice on the benefits of indexing. The major tobacco companies have protected their huge investments and kept millions of Americans hooked on cigarettes through powerful advertising and misinformation. Wall Street has managed to excuse the failures

of active strategies and dismiss the benefits of indexing for forty years, mostly by the sheer size of their sales and research staffs. (Why? One reason is that fees on actively-managed funds are often five times as high as on index funds.)

Although I believe a person should be able to smoke if he or she wants to, I do not want their smoking to affect my health and I do not want to pay for the higher insurance premiums and healthcare costs that are caused by their behavior. Similarly, individual investors, short-term speculators, traders, hedge funds, etc. can continue to trade stocks or time the market, but employees and taxpayers should not have to pay for the mistakes of their retirement plan administrators or elected officials as they hire and fire “beat-the-market”-type advisors.

Asset class investing (indexing) offers investors a healthier financial future. It won't always seem that way and the temptations to go back to the “hot manager/hot fund” world can be strong. So, for some, the TAMs of the world represent the Betty Ford Clinics of investing—keeping your head clear and focused in the right direction at all times.

Performance Notes:

Asset Class Returns—United States: 1-Yr. Bonds = DFA One-Year Fixed Income Portfolio; 5-Yr. Bonds = DFA Five-Year Government Portfolio; Large Stocks = Vanguard 500 Index Fund; Large Value Stocks = DFA Large Cap Value Portfolio; Small Stocks = DFA 9-10 Small Company Portfolio; Small Value Stocks = DFA Small Cap Value Portfolio. International: Large Stocks = 57% Vanguard Pacific Index Fund, 43% Vanguard Europe Index Fund (approximates the return of the Morgan Stanley EAFE Index); Large Value Stocks = Int'l Value Portfolio. Japan: Small Stocks = DFA Japanese Small Company Portfolio. Continental Europe: Small Stocks = DFA Continental Small Company Portfolio. United Kingdom: Small Stocks = DFA United Kingdom Small Company Portfolio. Pacific Rim: Small Stocks = DFA Pacific Rim Small Company Portfolio. Emerging Markets: Large Stocks = DFA Emerging Markets Portfolio. **TAM Portfolio Returns Net of Fees**—These are the actual returns of TAM portfolios in each risk category net of actual TAM management fees, custodial fees, and fund expenses. The “Growth” returns were calculated using a model portfolio from 12/31/92 to 4/30/93 and actual accounts thereafter. The “Aggressive” returns were calculated using a model portfolio from 12/31/92 to 3/31/93 and actual accounts thereafter. In both cases for the model performance, the maximum TAM fee was deducted, representative custodial costs were deducted, and all mutual fund returns are net of expenses. Past performance is no guarantee of future returns. This is especially the case with model portfolios which are not subject to specific economic or market factors. **Benchmarks**—Balanced Fund & Capital Appreciation Fund Indexes: Lipper Analytical's indexes representing the 30 largest balanced mutual funds and 30 largest capital appreciation mutual funds in the country.