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Worried about a major correction or even a "crash" in U.S. stock prices?

The S&P 500 fell 23% during the last quarter of 1987. Since then U.S. large stocks have risen 155%! If you had invested \$100,000 in the market before the crash on 9/30/87, it would be worth \$200,000 today.

What's different today? For one thing, bond prices are also rising, which wasn't the case in 1987. Bonds offered an alternative to high-priced stocks.

On the other hand, global investing was not as popular in 1987. Since international stocks have appreciated at less than half the rate of U.S. stocks since 1987 and far more investors are willing and able to shift assets to the international markets, could these markets benefit from a drop in U.S. stocks?

This newsletter is published by TAM Asset Management, Inc.
Editor: Jeffrey C. Troutner

Comments, questions, or suggestions are always welcome. For more information on our investment management services, please call 1-800-826-4015.

We are reprinting the final chapter of Charles Ellis' book *Investment Policy, 2nd Edition* this month. This book continues to serve as a very useful and practical reference for us in managing long-term portfolios and we encourage all investors, trustees, and retirement plan fiduciaries to obtain a copy and apply Ellis' principles. For ordering information, call 1-800-634-3966.

Individual Investors (Part 2)

Investment Policy: How to Win the Loser's Game

By Charles D. Ellis (Part 15 of 15)

Another all-too-human characteristic of most investors is paying too close attention to the day-to-day—even hour-to-hour—ups and downs of stock prices. Rationally, we know most of the changes in share prices are "noise" or almost random fluctuations. Consider the data: Most stocks will change by 4 percent or more between the high and low prices during each trading day. There are nearly 250 trading days a year, which would imply a total change in prices over the year of 1,000 percent (4 percent x 250 days). But the price of most stocks changes less than 15 percent net over a year, so more than 98 percent of the gross change is just flutter or noise. Investors should ignore the dance of stock prices, fascinating—and seductive—as the activity may be.

If you find yourself getting caught up in the excitement of a rising market or distressed by a falling market, stop. Break it off. Go for a walk and cool down.

Otherwise, you will soon become part of the "crowd," wanting to *do* something—and you will start making errors, perhaps grave errors that you will regret.

Individuals with large fortunes—\$25 million and over—can obtain good investment counsel as a "separate account." Those with less than \$2 million usually cannot. Their accounts are simply too small to be important to a first-rate firm.

Fortunately, all investors do have an alternative: mutual funds. Two types of funds have particular interest. One type is an index fund, run at low costs and fees and designed to replicate any one of several recognized market indexes such as the Standard & Poor's 500 or the Russell 2000* (see Chapter 3, *The Powerful Plodder*).

Continued on next page...

* Vanguard offers a series of such funds.

Are We Confused Yet?

These rankings from the August, 1993 issue of the *AII Journal* show the risks of relying on mutual fund selection services. The same kind of inconsistencies occur in brokerage firm wrap programs.

	Benham Target 2015	Fidelity Select Technology	Mutual Shares	Vanguard World Int'l Growth
Business Week* (2/93)	No rank	↓↓↓	↑↑↑↑	↓↓↓
Financial World (2/93)	A+	A+	C+	B+
Morningstar** (6/93)	★	★★	★★★★★	★★★★
Money (2/93)	C	C	B	D
Wall Street Journal (6/93)	A	A	D	D

* Three up arrows highest, three down arrows is lowest

** Five stars is highest, one star is lowest

Individual Investors (cont.)

Closed-end mutual funds are another type that is interesting, specifically those now selling at a discount *and* obliged by their bylaws to become open-end funds—which would eliminate the discount—within a reasonable time period, say five years. Such funds are particularly interesting if their long-term style of investing (“growth” or “value”) is currently out of favor and you can buy into them during their “off season.”

As with institutional investing, individuals who have a separate account will be wise to agree *in writing* with the investment manager on the overall program by which their funds will be invested: long term objectives, investment policy constraints, and performance expectations in various market environments. Individuals who invest in mutual funds can do nearly as much by reading carefully the written statement in each bond’s prospectus of its long-term objectives, policies, and performance expectations.

Each investor will increase her or his chances of achieving superior investment performance—which means reliably achieving your own explicit and realistic investment objectives—by taking time once a year for a formal, objective review of your investment objectives, financial resources, financial responsibilities, and recent investment results compared with prior realistic expectations.

While the focus of attention will typically be on investments, the following should also be examined: savings, insurance, bank credit available, current debts, probable obligations to help or support others in the “we,” annual income versus expenditure, and estate plans. The objective of this disciplined exercise is to “turn on the lights” and look over the whole situation

The investor who has successfully saved and invested enough to have ample funds for all chosen responsibilities or obligations has truly won the “money game.” This is an appropriately thrilling achievement. Winners should be careful never to put their victory back at risk, particularly by unnecessary or injudicious borrowing or by committing too much to any one investment or by overextending responsibilities and commitments. Winners

should avoid speculations striving to win big. It’s not worth the risk of losing enough to become a “non winner”—not just a loser, but truly a sucker. Winners should also be careful about being “too careful” as noted above: a shift to nominally “conservative” investing can leave investments exposed and at risk to the erosion of inflation.

As an individual investor, these ten “commandments” may be useful guides to thinking about your decisions on investments:

1. Don’t speculate. If you must “play the market” to satisfy some emotional “itch,” recognize you are gambling on your ability to beat the pros—and limit the amounts you play with to those you would gamble with the pros at Las Vegas. (Keep accurate records of your results, and you’ll soon convince yourself to quit.)
2. Don’t buy on tips. Ever. No matter how sure you feel a tip must be, let it pass. The only good tips depend upon having really important inside information. And using inside information is illegal.
3. Don’t do anything in investing for “tax reasons.” Tax shelters are poor investments. Tax loss selling is primarily a way for brokers to increase commissions. (One exception: making charitable gifts with low-cost stock can make sense *if you* were going to sell the stock anyway.)
4. Don’t think of your home as an investment. Think of it as a place to live with your family, period. Except when inflation surges—as it did in America in the late 1970s—and lifts the replacement cost of real estate *and* drives stock and bond prices down, owning residential real estate is not a great investment. Over the past 20

years, home prices have risen less than the consumer price index and have returned less than Treasury bills.

5. Never do commodities. Consider the experience of a commodities broker who, over a decade, advised nearly 1,000 customers on commodities. How many made money? Not even one.⁵
6. Don’t be confused about stockbrokers. They are usually very nice people, but their job is not to make money *for you*. Their job is to make money *from you*. While some stockbrokers are wonderfully conscientious people who are devoted to doing a good, thoughtful job for customers they work with over many, many years, you can’t *assume* your stockbroker is working that way for you. Some do, but most simply can’t afford it. (The typical stockbroker “talks to” 200 customers with *total* invested assets of \$5 million. To earn \$100,000 a year, he needs to generate \$300,000 in gross commissions, or 6 percent of the money he talks to. To generate this volume of commissions, the broker cannot afford the time to learn what is “right.” He has to keep the money moving—and it would be your money.)
7. Don’t invest in new or “interesting” investments. They are designed to be *sold to* investors, not to be *owned by* investors.⁶
8. Don’t believe what you hear from other investors. Most of their stories belong in the proverbial box so carefully labeled by the thrifty Bostonian: “string too short to save.”
9. While respecting money as a store of value and for the good it can do, don’t ever let money dominate you. If you find yourself adding it up more than three or four times a year, you are paying too much attention and are risking

⁵ *The Money Masters* by John Train (New York: Harper & Row, 1987).

⁶ My Aunt Saizie is in her 80s. After years and years of careful saving and wise investing, she built up a portfolio of common stocks worth nearly \$100,000. She asked me whether she should take the strong recommendation of a very nice-looking young man from the local broker’s office. His proposition: sell all her stocks (incurring a large capital gain) and put most of the money in Treasury bills for safety of principal and then use the rest to buy stock options so she could participate in any bull market that might come along. Fortunately, Saizie is too wise and experienced an investor to get drawn in by something that “interesting.” (Imagine the commissions that would have been generated for that broker!)

Individual Investors (cont.)

getting caught up in the crowd. Figuratively at least, “go take a walk” and cool off.

10. Don't trust your emotions. When you feel euphoric, you're probably in for a bruising. When you feel down, remember it's darkest just before dawn—and take no action. (Remember the test presented in this chapter?) The secret to long-term investment success is benign neglect. Let compounding work for you.

Finally, here are ten friendly suggestions that may prove helpful:

1. Get a pro. Investing is no place for amateurs (any more than the NFL). Be sure you have sensible professionals managing your investments. Books that say “you can do it” are popular—and some sell very well. That's why they're written. Read and enjoy them as entertainment. But don't believe them.

Andrew Tobias's *The Only Investment Book You'll Ever Need* is different—particularly worth reading as a primer. It's full of sensible advice and useful information.⁷

⁷If you would like to study the history of investment thinking, you might enjoy *Classics* and *Classics II*, both published by Business One Irwin.

2. Write out your long-term goals and your long-term plans—and stay with them. As every great coach advises his or her athletes: “Plan your play—and play the plan!”
3. If your long-term investment policy is not working out in the short run (e.g., stocks dropped sharply in price), your first assumption should be that you will “double up”—because you *know you* took considerable time and care in making your original policy decision.

Examine your long-term goals and your basic reasoning and the *long-term* evidence you used to be sure they were sound. Be very careful of “current” data from the last few years: such data tend to lead us astray. If the long-term evidence *is* still valid and your reasoning *was* sound, stay the course.

4. Be a student of investing and investors. Concentrate your studies on human psychology (not on the numbers and the financials) because most of the blunders we make are emotional, not computational errors.
5. Save.
6. Remember that money holds *powerful*—but different—symbolic meaning

for everyone. Respect the meaning others bring to it and the meanings you bring to it. And be careful.

7. If you find yourself tempted to ask, “What stock should I buy?” resist the temptation. If you *do* ask, don't listen to the answer. And if you do *hear* an answer, promise you won't act on it.
8. If you find yourself tempted to feel you are “just an individual investor” and therefore somehow not important, remember it's *your* money, you *are* the client, and the client's work is the most important part of achieving long-term success with investments.
9. Read the annual reports of Berkshire Hathaway, written by Warren Buffett. He's the most effective investor in securities in America and gives extraordinarily valuable lessons in these reports. (On request, they'll send you reprints of past reports.)
10. Remember that while price fluctuations command our attention, the real problem for investors is *inflation*. Price fluctuations come and go. Inflation *persists* and is unrelenting in the damage it does.

This much we know: When stock prices grow faster than underlying earnings, “corrections” occur.

We also know that trying to profit from these corrections involves two equally important decisions:

(1) *When to get out.*

(2) *When to get back in.*

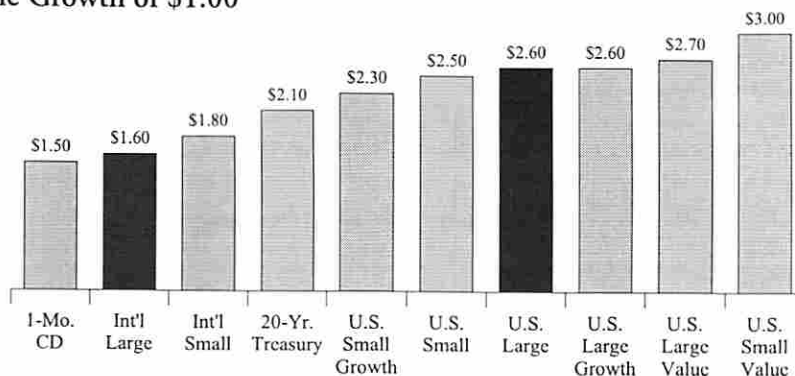
Only the worst investors bail out at the bottom. But what about the “smart” ones who get out before major drops?

You will find that most fail to move back in fast enough to make the move out profitable.

The Markets Since “The Crash”

(Jan. 1988 to Mar. 1995)

The Growth of \$1.00



Performance Notes:

Asset Class Returns: 1-Yr. Bonds = DFA One-Year Fixed Income Portfolio; 5-Yr. Bonds = DFA Five-Year Government Portfolio; U.S. Large Stocks = Vanguard 500 Index Fund; U.S. Large Value Stocks = DFA Large Cap Value Portfolio; U.S. Small Stocks = DFA 9-10 Small Company Portfolio; U.S. Small Value Stocks = DFA Small Cap Value Portfolio; Pacific Large Stocks = Vanguard Pacific Index Fund; Europe Large Stocks = Vanguard Europe Index Fund; International Large Value Stocks = DFA Large Cap International Portfolio; Japanese Small Stocks = DFA Japanese Small Company Portfolio; Cont. Europe Small Stocks = DFA Continental Small Company Portfolio; U. K. Small Stocks = DFA United Kingdom Small Company Portfolio; Pac Rim Small Stocks = DFA Pacific Rim Small Company Portfolio; Emerging Market 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, the maximum TAM fee was deducted, representative custodial costs were deducted, and all mutual fund returns are net of expenses. The "Moderate" returns were calculated using actual account performance since inception. 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.

Asset Class Returns		TAM Portfolio Returns																																																										
Year-to-Date Through 4/30/95		Through 4/30/95																																																										
<ul style="list-style-type: none"> U.S. Large Value Stocks 13.7% U.S. Large Stocks 12.9% U.S. Small Stocks 10.7% Europe Large Stocks 9.8% U.S. Small Value Stocks 9.5% U.K. Small Stocks 4.8% Cont. Europe Small Stocks 4.7% Int'l Large Value Stocks 4.6% 5-Yr. Bonds 3.5% 1-Yr. Bonds 3.2% Pacific Large Stocks 2.6% -1.2% Japanese Small Stocks -1.3% Emerging Market Stocks -8.6% Pac Rim Small Stocks 	<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="text-align: left;"></th> <th style="text-align: center;">YTD 1995</th> <th style="text-align: center;">1994</th> <th style="text-align: center;">1993</th> <th style="text-align: center;">Since Inception 12/92-4/95</th> </tr> </thead> <tbody> <tr> <td colspan="5">Risk (% stocks)</td> </tr> <tr> <td>Aggressive (95%)</td> <td style="text-align: center;">+4.8%</td> <td style="text-align: center;">+5.3%</td> <td style="text-align: center;">+21.1%</td> <td style="text-align: center;">+33.7%</td> </tr> <tr> <td>Growth (85%)</td> <td style="text-align: center;">+5.4%</td> <td style="text-align: center;">+2.6%</td> <td style="text-align: center;">+16.6%</td> <td style="text-align: center;">+26.0%</td> </tr> <tr> <td>Moderate (65%)</td> <td style="text-align: center;">+5.3%</td> <td style="text-align: center;">+2.1%</td> <td style="text-align: center;">+14.0%</td> <td style="text-align: center;">+22.6%</td> </tr> <tr> <td colspan="5">Benchmarks</td> </tr> <tr> <td>Balanced Fund Index</td> <td style="text-align: center;">+7.9%</td> <td style="text-align: center;">-2.2%</td> <td style="text-align: center;">+11.7%</td> <td style="text-align: center;">+17.9%</td> </tr> <tr> <td>Capital Apprec. Index</td> <td style="text-align: center;">+8.8%</td> <td style="text-align: center;">-2.5%</td> <td style="text-align: center;">+14.8%</td> <td style="text-align: center;">+21.9%</td> </tr> <tr> <td>S&P 500 Stock Index</td> <td style="text-align: center;">+13.0%</td> <td style="text-align: center;">+1.3%</td> <td style="text-align: center;">+10.1%</td> <td style="text-align: center;">+26.0%</td> </tr> <tr> <td>Salomon Broad Bond Index</td> <td style="text-align: center;">+6.5%</td> <td style="text-align: center;">-2.8%</td> <td style="text-align: center;">+9.9%</td> <td style="text-align: center;">+13.7%</td> </tr> <tr> <td>Morgan Stanley EAFE Index</td> <td style="text-align: center;">+5.8%</td> <td style="text-align: center;">+8.0%</td> <td style="text-align: center;">+32.9%</td> <td style="text-align: center;">+51.9%</td> </tr> </tbody> </table>						YTD 1995	1994	1993	Since Inception 12/92-4/95	Risk (% stocks)					Aggressive (95%)	+4.8%	+5.3%	+21.1%	+33.7%	Growth (85%)	+5.4%	+2.6%	+16.6%	+26.0%	Moderate (65%)	+5.3%	+2.1%	+14.0%	+22.6%	Benchmarks					Balanced Fund Index	+7.9%	-2.2%	+11.7%	+17.9%	Capital Apprec. Index	+8.8%	-2.5%	+14.8%	+21.9%	S&P 500 Stock Index	+13.0%	+1.3%	+10.1%	+26.0%	Salomon Broad Bond Index	+6.5%	-2.8%	+9.9%	+13.7%	Morgan Stanley EAFE Index	+5.8%	+8.0%	+32.9%	+51.9%
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