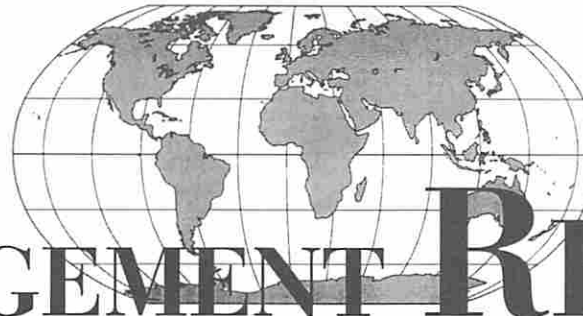


TAM ASSET MANAGEMENT REVIEW

Modern Investment Principles
For Serious Investors

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Every client of TAM Asset Management receives a copy of Charles D. Ellis' book *Investment Policy*. This book is one of the most useful, objective, and contemporary sources on prudent investment strategy. It is also less than 100 pages long and very easy to read.

Mr. Ellis is managing partner of Greenwich Associates, the leading consulting firm specializing in financial services worldwide. The author of six books and dozens of articles, he has taught courses at both Yale and Harvard. Ellis earned his B.A. at Yale, an M.B.A. (with distinction) at Harvard and the Ph.D. at New York University.

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Redefining "conservative"

By Jeff Troutner

The American Heritage Dictionary defines "conservative" as:

1. Tending to oppose change.
2. Moderate; cautious; restrained.

For those of us who have studied the history of the financial markets and the evolution of investment theory and practice, these two definitions are in stark conflict with one another. "Tending to oppose change" in the investment business is tantamount to financial suicide. At the very least, it ignores the significant contribution computers have made to our understanding of the influences on security prices and the breakthrough research emanating from major universities and the offices of firms like Dimensional Fund Advisors.







By challenging traditional views and developing much improved and more modern principles of portfolio management, financial researchers and industry practitioners have shown investors better ways to improve portfolio returns while staying true to the second definition of being "moderate, cautious, and restrained."

To illustrate, let's compare a "traditional" conservative portfolio with a "modern" conservative portfolio. As you will see, the modern conservative portfolio offers a higher expected return with much greater diversification, less volatility over the long-term, and less downside risk.

The traditional conservative portfolio is typically managed by a "balanced" manager or a combination of a "blue-chip" stock manager and a bond manager. The asset mix for this illustration is 35% stocks/65% bonds.

Continued on next page...

Asset Class Returns* Through August 31, 1994

	<u>United States</u>	<u>YTD 1994</u>
	1-Yr. Bonds	+1.7%
	5-Yr. Bonds	-1.7%
	Large Stocks	+3.9%
	Large Value Stocks	0.0%
	Small Stocks	+4.2%
	Small Value Stocks	+5.6%
	<u>International</u>	
	Large Stocks	+13.2%
	<u>Japan</u>	
	Small Stocks	+39.3%
	<u>Continental Europe</u>	
	Small Stocks	+18.0%
	<u>United Kingdom</u>	
	Small Stocks	+10.0%
	<u>Pacific Rim</u>	
	Small Stocks	-7.2%

August was another good month for stock prices around the world. U.S. stocks in particular staged a pretty good comeback, but bond prices have remained flat for the most part. Pacific Rim stocks continue to move higher and as of this writing (9/12) sit at -4.6% for the year.

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

TAM Portfolio Returns Net of Fees*

Through August 31, 1994

Risk (% stocks)	Year-to-Date		Since Inception
	1994	1993	12/92-8/94
Aggressive (95%)	+10.6%	+21.1%	+33.9%
Growth (85%)	+6.9%	+16.6%	+24.5%
Moderate (65%)	+5.5%	+14.0%	+20.3%

Benchmarks Comparisons

Balanced Fund Index	+0.9%	+11.7%	+12.7%
Capital Apprec. Index	-0.2%	+14.8%	+14.6%
S&P 500 Stock Index	+3.9%	+10.1%	+14.4%
Salomon Broad Bond Index	-1.8%	+9.9%	+7.9%

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

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Redefining "conservative" (cont.)

The expected return and annual volatility for the traditional portfolio are shown in column 1 below.

The expected return can be increased by simply shifting more of the assets to stocks. However, as shown in column 2, this "quick fix" has only a slight impact on annual return, but a rather significant impact on portfolio volatility and downside risk. This is the traditional "balanced" portfolio offered by brokers and advisors.

Another way to improve returns—very popular at the moment—is to add international stocks to the portfolio (column 3). Again, the expected return improves, but at the expense of additional volatility and downside risk.

As an alternative, most brokers or consultants will suggest hiring a "better" money manager to boost perfor-

mance. But since superior management (higher than market returns net of fees) cannot be predicted with any degree of certainty, and since portfolio diversification would remain wholly inadequate by today's standards this is not the most attractive alternative for investors or investment fiduciaries.

Much broader and efficient diversification is a viable, prudent, and modern alternative with the introduction in recent years of many specialized indexed mutual funds. Columns 4 & 5 show the impact of this broad stock diversification and a reduction in the average maturity of the bonds in the portfolio.

These improvements in portfolio risk/return characteristics can be achieved without the confusion, expense, uncertainty, and serious lack of diversification of manager or mutual fund selection services. Table 2

shows the increased diversification and reduction in costs using indexed mutual funds to create the Modern portfolios.

It is a fact of life in the investment industry that the evolution from traditional to modern views of "conservative" will be slow among small investors and many fiduciaries of retirement, trust, and eleemosynary funds. These investors are serviced by the major brokerage firms, bank trust departments, and mutual fund companies that continue to promote under-diversified stock picking and market timing strategies. These advisors are aware of the implications of the research I have just presented, but are reluctant to change because of their huge investment in traditional strategies. Smart investors will become better informed and choose the route that best suits their needs.

	1 Traditional "Conservative" Portfolio	2 Traditional "Balanced" Portfolio	3 Traditional "Global" Portfolio	4 Modern "Conservative" Portfolio	5 Modern "Balanced" Portfolio
21 Years: 1973-1993					
Asset Allocation¹	35% U.S. large stocks 65% Intermediate bonds	65% U.S. large stocks 35% Intermediate bonds	32.5% U.S. large stocks 32.5% Int'l large stocks 35% Intermediate bonds	35% Diversified stocks 65% Short-term bonds	65% Diversified stocks 35% Short-term bonds
Annual return	10.4%	10.9%	11.7%	12.6%	14.4%
Annual volatility (Std. Dev.)	9.7%	12.8%	13.2%	7.6%	12.5%
Worst 1-Year Period	-9.1%	-17.1%	-15.7%	-2.1%	-12.3%
Worst 3-Year Period	1.9%	-0.9%	-0.3%	5.5%	2.2%
Worst 5-Year Period	4.5%	2.5%	3.5%	8.8%	8.9%
Worst 7-Year Period	4.8%	4.2%	5.7%	10.2%	11.6%
Worst 10-Year Period	7.5%	7.3%	7.6%	12.5%	13.3%

	Traditional "Balanced" Portfolio	Traditional "Global" Portfolio	Modern "Balanced" Portfolio
Number of asset classes	2	3	7
Number of stocks²	80	144	7,800
Average expense ratio²	1.16%	1.60%	.43%

¹ U.S. large stocks = S&P 500 Index; Intermediate bonds = Lehman Brothers Gov'l/Corp. Bond Index; Modern "Conservative" = 30% DFA 1-Year Fixed Income fund, 35% DFA Five-Year Government fund, 6% S&P 500 Index, 6% DFA Large Cap Value Fund, 6% DFA 9-10 Small Company fund, 6% DFA Small Cap Value fund, 6% Morgan Stanley Europe, Australia, and Far East Index, and 5% DFA International Small Company funds; Modern "Moderate" = 15% DFA 1-Year Fixed Income fund, 20% DFA Five-Year Government fund, 11% S&P 500 Index, 11% DFA Large Cap Value Fund, 11% DFA 9-10 Small Company fund, 11% DFA Small Cap Value fund, 11% Morgan Stanley Europe, Australia, and Far East Index, and 10% DFA International Small Company funds; ² Mutual fund data from Morningstar.

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; 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). 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.

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. The "Aggressive" returns were calculated using a model portfolio from 12/31/92 to 3/31/93. In both cases, 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.