

TAM ASSET MANAGEMENT REVIEW

Facts & figures on global
investment strategies

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The Issue: Fees & Performance

Venture Annuity: An Example of Slick Marketing vs. Good Sense

The Loser? Uninformed Investors

Too often investors assume a service offered by a broker or money manager is "value-added" because of the size and reputation of the firm or quality of the marketing material used to make the sale.

But investors can pay a high price for flashy marketing and persistent sales techniques and the cost can come in several forms:

- Higher fees and commissions
- Inferior performance
- Diversion from less costly, value-added services

An example of all the above was illustrated in the July 13 issue of The Wall Street Journal in a story titled "Variable Annuity Buyers Warned To Check Underlying Funds". It shows that the Venture Variable

Annuity, for one, deducts fees as high as 3.75% *per year* from contract holders. For this meager fee investors (clients of Shearson, PaineWebber, and others) have had the not-so-pleasant experience of below-average performance in 7 out of the 9 underlying funds!

When competitive fees and good performance is lacking, the insurance companies and brokers keep investors in the program with high "surrender" charges over extended periods. In the case of the Venture annuity, the surrender charge starts at 6% of the asset value and declines to 0% over six years!

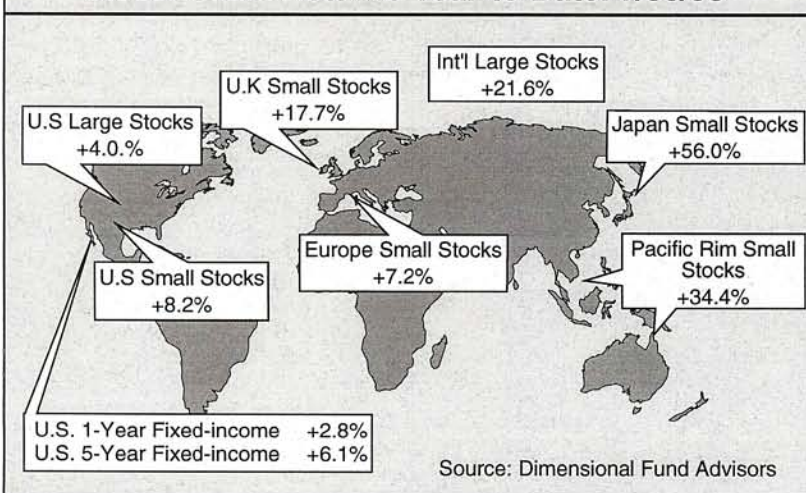
As if that's not enough salt-in-the-wound, it is very likely that the broker or insurance agent who sold you

the annuity spent a relaxing all-expense paid vacation for two in Hawaii for doing such a good job for his ~~clients~~ brokerage firm. This year, I think he goes to Rome.

Brokers at PaineWebber or Shearson have no excuse when investors discover that there are better investments elsewhere. These are "full-service" brokers who are expected to do the research and offer the best alternatives to their clients. Can an annuity with a 3.75% annual expense and inferior fund performance really be the best alternative? The very best money managers can't expect to outperform a multi-market indexed portfolio over the long-term, let alone after a 3.75% annual fee.

Caveat emptor.

Asset Class Returns Year-to-Date: 7/30/93



"We Only Recommend Superior Managers..."

Investors can ignore the high fees. They can ignore the lack of security and market diversification. They can even ignore the fact that no one can predict which managers will be "superior" in the future. But, how can they ignore the fact that after a 1% fee, only 4 managers out of 18 have shown better-than-market returns over the past five years (ended 12/31/92)?

This is the track record of one brokerage firm's "wrap" program which promises access to superior managers. Marketing?

Selecting the Right Funds Is Only One Step

Education, continuing reinforcement of principles & discipline are critical to long-term success

Investors can purchase no-load index funds through organizations like Vanguard, Schwab, and others. To *optimize* the risk/return characteristics of the portfolio, however, investors should not ignore the importance of fund specialization, diversification, and expense ratios, or the correlation of fund returns.

Only an index fund *specialist* can provide the best combination of all of these factors. Since institutional investors demand specialization and low fees, a fund company that caters to these investors should be our first choice—Dimensional Fund Advisors (DFA) meets the test. DFA manages over \$7 billion in institutional assets and is one of the forerunners in the indexing area. The broad selection of specialized domestic and international index funds is unmatched in the industry and their top people are among the Who's Who of modern portfolio theory.

But fund selection is only one step in a long process. The single most important factor in the long-term success of asset class investing is to determine the *optimum* portfolio mix and *stay the course*. If you lack the discipline to avoid moving in and out of markets or temporarily overemphasizing one market, you are doomed to fail. The market timing velociraptor will eat you.

Busy professionals are the worst in this regard. After being burned by broker after broker selling limited partnerships, annuities, commodity funds, inferior money managers and "reverse osmosis collateralized mortgage STRIPS", they take matters into their own hands. They subscribe to some mutual fund newsletter guru who missed the '87 crash and has returned 3,000% over the last 1.25 years. They buy no-load funds through Vanguard and all's well. For awhile.

Few professional money managers can avoid the lure of market timing, let alone physicians, business executives, or the average 401(k) plan participant. Subject these investors to the constant cold calls from brokers and financial planners and the outcome is pretty predictable.

The table below is one way of illustrating the potential cost of moving in and out of markets. The article on the right suggests that along with management fees and commissions, bad advisors can cost a portfolio a great deal more.

In the final analysis, everything we do for our clients is secondary to providing a *steady hand on the tiller*.

The Cost of Market Timing

Period	S&P 500 Annual Return
1980-1989	
All 2,528 trading days	17.5%
Minus 10 best Days	12.6%
Minus 40 best days	3.9%

Source: Cambridge Associates.

Forbes Columnist Measures Real Cost of Manager "Advice"

Mark Hulbert writes in the American Association of Individual Investors (AAII) Journal: "We all know—based on many studies—that the average investment advisor doesn't beat the market. But less clear is the explanation for this underperformance. Is market timing or stock selection to blame? Or is it a combination of both?"

In order to answer these questions for investment newsletters, the challenge was to extract from each of their model portfolios a pure timing and a pure selection component, and to measure each of these individually.

The study found that the impact of both the timing and selection decisions over the 12 1/2 years through 1992 was negative, and that both pursuits cost the portfolios roughly the same amount. **On average, market timing cost the portfolios 2.2% per year and selection 2.2%.**

The study covered the period from mid-1980 through the end of 1992."

Hulbert is a regular columnist for Forbes magazine.

The Role of An Advisor Today:

Educator—basic investment principles, objective research, assistance in formulating individual objectives.

Communicator—on-going reinforcement of principles, reports on progress of portfolio, reference source for books, articles, and papers confirming approach.

Professional "Hand on the Tiller"—no market timing, rebalancing for risk control, fiduciary responsibility, strict adherence to discipline.

Yesterday's Advisors:

Stockpicker—adds risks of bad selection and low diversification, higher fees, no value-added long-term.

Market timer—short-term, high risk, higher fees, no value-added.

Investment management "consultant"—charges a fee to select superior managers knowing superior returns cannot be predicted. Playing against the odds, higher fees for no value-added. "Earns" fee for recommending a new "superior" manager when first recommendation fails.

Seller of investment "products"—the real dinosaurs of the industry. High fees, high risks, advantage always with product creator and marketers.