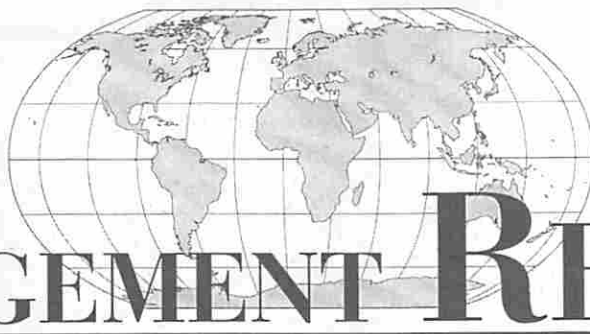


TAM ASSET MANAGEMENT



Facts & figures on global
investment strategies

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REVIEW

Investment Policy: How to Win the Loser's Game, by Charles D. Ellis Part 1 of 14: Conclusion

Every client of TAM Asset Management receives a copy of Charles D. Ellis' book *Investment Policy*. This book is by far the most useful, objective, and contemporary source on prudent investment strategy I have seen in fifteen years of studying the subject. 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.

Reprinted from *Investment Policy, 2nd Edition*, by Charles Ellis with the permission of Irwin Professional Publishing. All rights reserved. For ordering information, call 1-800-634-3966.

We are starting off with the last chapter of the book since it summarizes so well the reasons for providing this information to you.

Jeff Troutner
TAM Asset Management, Inc.

Clients—not their investment managers—have the most important job in successful investment management. Clients' central responsibilities are to decide on their long-term investment objectives and, with the expert advice of professional managers, determine a well-reasoned and realistic set of investment policies that can achieve the specified objectives of the client.

Only by separating responsibility for investment *policy* from responsibility for portfolio *operations* can a client delegate to a manager the authority to implement policy in daily portfolio operations without abdicating the client's responsibility for defining objectives and making sure that investment policies are designed to achieve the chosen objectives.

The Purpose of Investment Policy

The great purpose of investment policy is to provide sound guidelines to the portfolio manager, particularly when market conditions are most

distressing and create the most urgent anxiety about the true wisdom of those policies.

Clients should study their total investment situation and their emotional tolerance of risk and the history of investment markets, because a mismatch between the market's sometimes grim realities and the financial and emotional needs of the investor can result and has resulted in great harm.

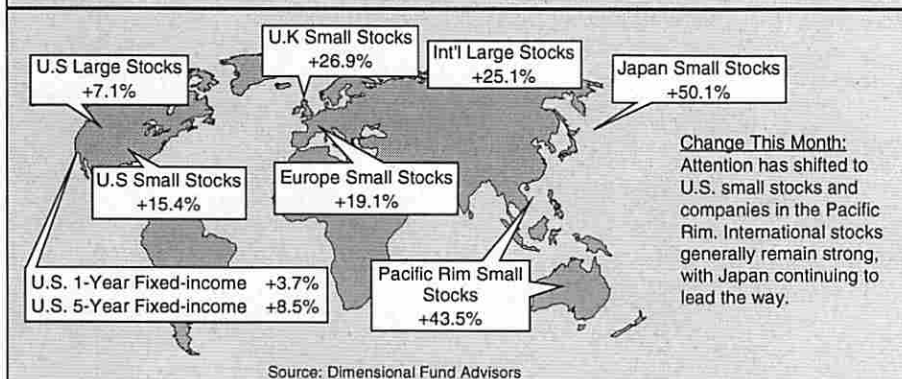
Clients who study the realities of investing will be able to protect themselves and their investments from the conventional hope that they can find portfolio managers who will "beat the market". These clients will understand that the only way an active investment manager can beat the market is to find and exploit other investors' mistakes more often than they find and exploit his.

Times Have Changed

But so many investment managers are so very good at their work that they don't make enough mistakes; therefore, it is unlikely that any large institutional investor will be able to beat his professional competitors, either substantially or consistently. Most of the managers and clients who insist on trying will be disappointed by the results. It is a loser's game.

Happily, there is an easy way to win the loser's game by not playing—at least not playing by the conventional

Asset Class Returns Year-to-Date: 9/30/93



Continued on back...

Investment Policy (cont.)

rules that are now out of date. As George Marshall counseled his senior officers on the way to winning World War II: "Don't fight the problem." Accept reality. Times have changed.

A New Approach

Even as the existing old ways of managing portfolios to beat the market have become obsolete, a new approach is now available—and works. It downplays portfolio operations, particularly of the heroic variety, and concentrates on carefully thought through, well-documented, and well-defined *policy*.

Recognizing that higher returns are the incentive and reward for investors taking—and sustaining—an above-average market risk and that the highest returns therefore come from equity investments, clients should set their portfolios' asset mix at the highest ratio of equities that their economic limitations can afford and sustain.

Understand Market Risk

To do their work well, clients must understand the turbulent nature of markets in the short term and the basic consistency of markets in the long term. This understanding will enable the effective client to increase his or her tolerance for interim market fluctuations and to concentrate on the long-term purpose of the portfolio, taking appropriate full advantage of any investor's greatest resource: time.

Soundly conceived, persistently followed long-term investment policy is the pathway to success in investing. The actions required are not complicated. The real challenge is to commit to the discipline of long-term investing and to avoid the compelling distractions of the excitement that surrounds, but is superfluous to, the real work of investing. This commitment to the discipline of long-term investing is the principal responsibility—and opportunity to contribute—of the *client*.

You now know all you will ever need to know to be truly successful with investments—as a *client*.

Match Risk With Your Time Horizon

By Jeff Troutner

The single most important step an investor should take before deciding on an investment strategy is to determine how long the assets can be invested. The reason is simple—the higher the year-to-year volatility of a diversified portfolio the higher the expected return, and the longer your investment time horizon the less relevant year-to-year volatility becomes.

Chart 1 shows the yearly returns since 1972 for one-month CDs and an "Aggressive" asset mix of 5% CDs, 10% U.S. large stocks, 15% international large stocks, 35% U.S. small stocks, and 35% international small stocks. The annual return for CDs was 8.6% versus 16.5% annually for the Aggressive mix.

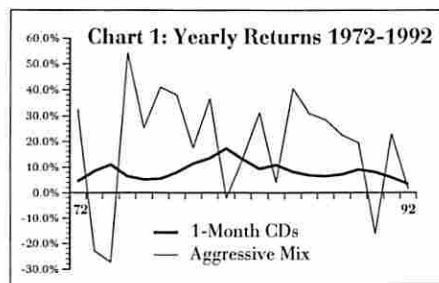
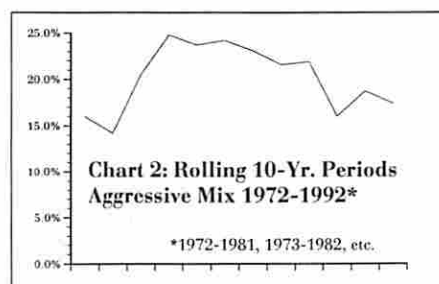


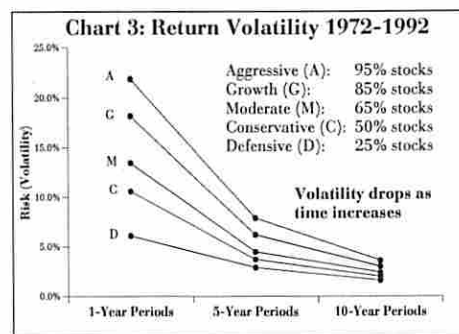
Chart 2 shows rolling ten-year periods for the Aggressive mix. Volatility (standard deviation) drops from 21.9% on a one-year basis to 3.9% over rolling ten-year periods—not much more than the 3.3% annual volatility of CDs.



You Must Sleep Well, However

Before an investor decides on the aggressiveness of a portfolio he should study the *range* of returns for 1, 5, & 10-year periods. Knowing that equity markets grow over time and that patience will be rewarded is one thing—living with short-term volatility and the risk that the assets will have to be tapped earlier than expected is another.

Part of the job of any good investment manager should be to explain market risks, develop a number of asset mix scenarios, and assist clients in choosing the right one for *their* needs. Chart 3 shows the volatility of the 1, 5, and 10-year returns for five different asset mixes since 1972.



Factor In Costs

The *cost* of implementing a diversified strategy can offset the benefits if investors are not careful. Remember, costs include mistakes in stockpicking and market timing, as well as management fees and expenses.

Highly diversified, no-load index funds eliminate stockpicking and market timing costs for investors. The fees and expenses for these funds are also substantially lower than the average no-load stock fund.

Summary

The steps an investor should take before deciding on a strategy include:

- 1) determine a realistic time horizon;
- 2) study the volatility and returns of various asset classes;
- 3) efficiently combine asset classes to meet personal risk tolerance;
- 4) control costs—primarily by eliminating manager mistakes—and
- 5) choose an advisor who will assist you all along the way.

The returns shown above do not represent actual TAM portfolios. A complete description of the data used in these illustrations is available on request. Past performance does not necessarily indicate future results.