



Index Fund Strategies

# ASSET CLASS<sup>®</sup>

A monthly update of asset class performance, trends, & topics for long-term investors

## Index Returns

|                     | 1998  | 1999 | 2000  | Last 8 yrs. | 7/26 2001 |
|---------------------|-------|------|-------|-------------|-----------|
| <b>Bonds</b>        |       |      |       |             |           |
| Short-term          | 5.7   | 4.6  | 6.7   | 5.5         | 3.1       |
| S-T Global          | 8.4   | 3.7  | 6.7   | 7.5         | 3.2       |
| Intermediate        | 10.5  | -3.6 | 13.5  | 6.9         | 4.6       |
| Long-term           | 12.0  | -7.9 | 16.6  | 8.5         | 5.3       |
| <b>U.S. stocks</b>  |       |      |       |             |           |
| Large Market        | 28.7  | 20.8 | -9.1  | 17.0        | -8.4      |
| Large Value         | 12.0  | 4.8  | 10.2  | 15.5        | 8.1       |
| Small Micro         | -7.3  | 29.8 | -3.6  | 13.8        | 19.5      |
| Small Market        | -5.4  | 25.4 | 2.5   | 12.6        | 10.6      |
| Small Value         | -7.3  | 13.1 | 9.0   | 14.8        | 21.1      |
| Real estate         | -15.4 | -2.0 | 28.4  | 9.2         | 8.8       |
| <b>Int'l stocks</b> |       |      |       |             |           |
| Large Market        | 18.2  | 28.5 | -14.0 | 10.3        | -17.9     |
| Large Value         | 14.9  | 16.3 | -0.2  | 12.1        | -9.8      |
| Small Market        | 8.2   | 21.9 | -5.4  | 4.9         | -2.3      |
| Small Value         | 5.3   | 19.0 | -3.1  | 4.7         | 3.0       |
| Emerg. Mkts.        | -9.4  | 71.7 | -29.2 | 6.6         | -11.1     |

### Descriptions of Indexes

|                    |                                 |
|--------------------|---------------------------------|
| Short-term bonds   | DFA One-Year Fixed Income fund  |
| Intermediate bonds | DFA Intermed. Gov't Bond fund   |
| Long-term bonds    | Vanguard Bond Index Long-term   |
| S-T Global bonds   | DFA Five-Year Global Fixed      |
| U.S. Large Market  | Vanguard Index 500 fund         |
| U.S. Large Value   | DFA Large Cap Value fund        |
| U.S. Small Micro   | DFA US 9-10 fund                |
| U.S. Small Market  | DFA US 6-10 fund                |
| U.S. Small Value   | DFA US 6-10 Value fund          |
| Real Estate        | DFA Real Estate Securities fund |
| Int'l Large Market | DFA Int'l Large Cap fund        |
| Int'l Large Value  | DFA Int'l Large Cap Value fund  |
| Int'l Small Market | DFA Int'l Small Company fund    |
| Int'l Small Value  | DFA Int'l Small Cap Value fund  |
| Emerging Markets   | DFA Emerging Markets fund       |

"Last 8 yrs." returns for U.S. Large Value (3/93), U.S. Small Value (3/93), Int'l Large Value (3/93), Int'l Small Market (10/96), Int'l Small Value (1/95), and Emerging Markets (5/94) include simulated data prior to fund inception (in parentheses).

This information is obtained from sources we believe are reliable, but we cannot guarantee its accuracy.

**Past performance does not guarantee future returns.**

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**TAM Asset Management, Inc.**  
 601 California St. Suite 701  
 San Francisco, CA 94108  
 phone: 415-951-1937  
 Efax: 781-623-4691  
 email: trout@tamasset.com  
 Web Site: www.tamasset.com  
 Editor: Jeffrey C. Troutner

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## Markets Update Thursday, July 26, 2001

The news out of Dotcomville is still pretty bleak with the demise of Webvan. I have to admit that I shook my head in disbelief every time I saw one of those vans drive by. How could they possibly believe that (a) delivering (b) low margin groceries to (c) busy people within a (d) a small delivery time window could succeed? Answer: They didn't, really. All the venture capital people cared about was getting in early and cheap and getting out as fast as they could via an initial public offering (IPO). It's been a classic and consistent way to transfer wealth from the pockets of many—individuals, either on their own or through mutual funds, who don't know they are speculating—to the pockets of a few—wealthy individuals who *know* individual investors are speculating. The other losers, of course, are the thousands of fired employees who thought they were joining a legitimate business with a viable business plan. The primary facilitators in this wealth transfer game, as always, are the stockbrokers and "analysts" at the major Wall Street wire houses who put out the "Buy!" recommendations.

Of course, that's how a free market works. The only way it is going to change for the better is if the average investor figures out the difference between speculation and investing and the venture capitalists are forced to develop more sensible business plans and wait longer for their big payoff. But don't hold your breath waiting for that to happen. Greed and herd instinct are much too powerful forces for most investors to resist.

## DFA's Time to Shine

*All Index Funds Are Not Created Equal*

Jeff Troutner, TAM Asset Management

Jason Zweig, a columnist for *Money* magazine, recently wrote an article on the shortcomings of the S&P 500 index (*Is the S&P 500 rigged?* June 13, 2001 money.com). His conclusion: "...investors have continued to apply the S&P 500 as a universal benchmark rather than the growth-stock index it has become."

Gee, I wonder why, Jason? Maybe it's because you, John Bogle of the Vanguard Group, Jonathan Clemens of *The Wall Street Journal* and many others have touted the S&P 500 index and its kissing cousin, the Total Market Index (Wilshire 5000) as the perfect investment vehicle over the last six years! It took a crash in the technology and telecom sectors to convince you to point out something to investors that people like myself have been saying for a long time.

Unfortunately, my audience, and therefore my influence, is not nearly as large as the investment gurus noted above and too many investors have found out the hard way that greater asset class diversification beyond the traditional "market" indexes might be a worthwhile pursuit.

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Now, don't get me wrong. I have great respect for Messrs. Zweig, Bogle, and Clements. Mr. Bogle, after all, is considered one of the most influential proponents of indexing and is credited with starting the first indexed mutual fund. Mr. Clements writes the very useful "Getting Going" column in the *Journal* and has been a consistent champion of indexing. As far as I'm concerned, Mr. Zweig's column is the best thing going at *Money* and the only source on indexing insights you'll find there. But all have failed to warn investors of the dangers of asset class concentration in these "market" indexes—until now.

The next thing we *might* see from Jason Zweig and maybe Jonathan Clements (but probably not John Bogle) is a thoughtful analysis of the difference in asset class indexes beyond the S&P 500. Returns so far this year might prompt them to do so, but we won't wait.

The table below shows the performance difference year-to-date for some Vanguard index funds and their Dimensional Fund Advisors (DFA) counterparts.

**Returns Through July 26, 2001**

**Large Value**

|   |        |
|---|--------|
| Vanguard Value<br><i>S&amp;P/Barra Value</i>      | - 4.6% |
| DFA Large Value<br><i>Fama/French Large Value</i> | + 8.1% |

**Small Growth**

|  |         |
|--|---------|
| Vanguard Small Growth<br><i>S&amp;P 600/Barra Growth</i> | - 3.2%  |
| Vanguard Small Cap<br><i>Russell 2000</i>                | + 1.9%  |
| DFA Micro Cap (9-10)<br><i>CRSP 9-10</i>                 | + 19.5% |
| DFA Small Cap (6-10)<br><i>CRSP 6-10</i>                 | + 10.6% |

**Small Value**

|   |         |
|---|---------|
| Vanguard Small Value<br><i>S&amp;P 600/Barra Growth</i> | + 10.6% |
| DFA Small Value<br><i>Fama/French Small Value</i>       | + 21.1% |

(underlying index in italics)

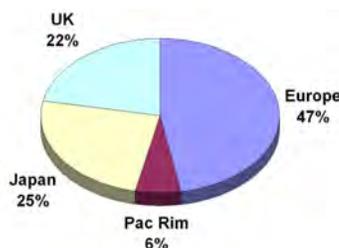
What this shows is that during periods when small company and value stocks shine, the DFA funds should provide higher returns than the Vanguard funds. If you believe, as I do, that small company and value stocks represent separate asset classes with risk and return characteristics that make them attractive for a diversified, long-term portfolio then the goal should be to use asset class funds that more fully exploit these characteristics. The time frame we use here isn't important unless your investment time horizon is relatively short (in which case your overall equity exposure is the most important consideration) or if you believe you can consistently predict asset class trends. If the latter is the case, you would have owned the Vanguard funds from 1995-1999 and switched to the DFA funds thereafter.

In lieu of a successful crystal ball strategy, I recommend a more balanced asset class portfolio of index funds that more fully exploits each asset class's risk/return benefits. Using the DFA funds and including the S&P 500 as simply the *large company growth* component it has been for some time, achieves that goal.

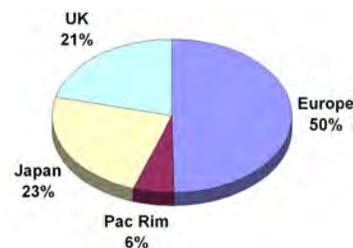
**FYI: Country Weights for DFA Funds**

As of June 30, 2001

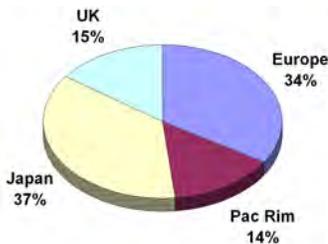
**Int'l Large Cap**



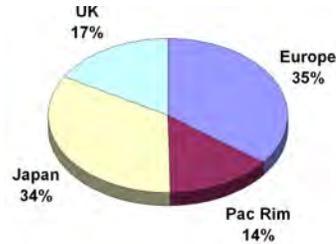
**Int'l Value**



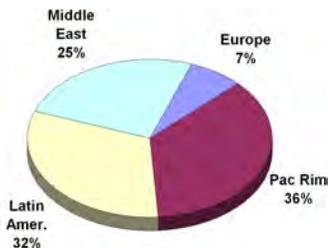
**Int'l Small Co.**



**Int'l Small Value**



**Emerging Markets**



**Number of Countries**

|                   |     |
|-------------------|-----|
| Int'l Large Cap   | 21  |
| Int'l Value       | 21  |
| Int'l Small Co.   | 21  |
| Int'l Small Value | 20* |
| Emerging Mkts.    | 14  |

\* excludes Greece