Index Fund Strategies

ASSETCLASS®

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

Index Returns

	1998	1999	2000	Last 8 yrs.	3/21 2001
Bonds					
Short-term	5.7	4.6	6.7	5.5	**1.5**
Intermediate	10.5	-3.6	13.5	6.9	**3.9**
Long-term	12.0	-7.9	16.6	8.5	**4.4**
S-T Global	8.4	3.7	6.7	7.5	**1.7**
U.S. stocks					
Large Market	28.7	20.8	-9.1	17.0	**- 14.8**
Large Value	12.0	4.8	10.2	15.5	**- 0.5**
Small Market	-7.3	29.8	-3.6	13.8	**- 1.9**
Small Value	-7.3	13.1	9.0	14.8	**3.1**
Real estate	-15.4	-2.0	28.4	9.2	**- 1.8**
Int'l stocks					
Large Market	18.2	28.5	-14.0	10.3	**- 13.8**
Large Value	14.9	16.3	-0.2	12.1	**- 9.9**
Small Market	8.2	21.9	-5.4	4.9	**- 4.4**
Small Value	5.3	19.0	-3.1	4.7	**- 0.9**
Emerg. Mkts.	-9.4	71.7	-29.2	6.6	**- 7.7**

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 Market	DFA US 9-10 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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Markets Update

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Is The Sky Falling?

It all depends on your perspective

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We are living through one of the most dramatic times in stock market history. In just over one year, we have gone from unbridled optimism to the doom and gloom brought on by last week's record point drop for the Dow. Driving all of this, of course, are the tech stocks that no one could get enough of 15 months ago and today sit over 60% lower than their highs as measured by the NASDAQ index. There are some brights spots—value stocks and small company stocks have generally done much better—but investors are finding very little to be happy about today.

How do *you* feel about this market climate? It should depend on what your portfolio is set up to do for you. One way to group investors and their objectives are as follows :

1. **Those who are steadily putting money away for their retirement or other longer term objective**
2. **Those who are retired, but have other assets than their stock portfolio to cover their living expenses**
3. **Those who are retired and must draw down their investment portfolio to cover their living expenses**

If you are in the first group and you have a good, solid understanding of how the financial markets work, you should welcome a period of flat to declining markets. In fact, the longer the period lasts the happier you should be—up until you have to start selling investments to support your lifestyle. For many of us, that's hopefully a long time from now. Think of your investment program as a trip to the supermarket. Are you happier to find your bread, milk, and produce prices declining or rising? Why then would you be happier to pay ever-increasing prices for your stocks? Bragging rights? A greater feeling of wealth? Both of these have gotten a lot of investors in trouble over the last year. Instead, why not take pride and comfort in your ability to steadily put money away and buy stocks at whatever prices the current market environment offers? And remember, low prices today (relative to earnings and dividends) mean higher returns in the future and higher prices today mean lower returns in the future.

If you are in the second group your ability to accumulate more stocks at lower prices has diminished. But you have no need to sell stocks to pay living expenses so you have time for these stocks to build value. In the meantime, you should be receiving dividends to reinvest, or your companies are plowing back earnings to fuel future growth. The effects of compounding, periodic rebalancing, and reinvestment of interest and dividends are all in your favor.

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If you are in the third group, flat or declining markets should only be a concern *if you failed to plan ahead*. Unfortunately, euphoric markets like we have had recently have a way of postponing good, wise planning. I am not an advocate of "retiring" a portfolio once you have retired from your working career. Life expectancies are too high for that. But setting aside a minimum of three years of living expenses in short-term fixed income securities while letting the rest of your portfolio grow in well-diversified stock index funds is often a wise choice, particularly since inflation is always a threat. If you know of someone who has failed to plan for a market environment like today's, assure them that *now is not the time to panic*. They should seek experienced investment counsel and consider ways to restructure their investment portfolio with the minimal amount of "damage." If your own situation will be changing within the next five years and you expect to withdraw from your investment portfolio, plan for that eventuality today.

For the well-informed and diversified investor, the current market environment offers more opportunity than challenge. Continue to invest on a regular basis to take advantage of lower prices; maintain your long-term asset allocation; do not "spend" stock portfolio earnings that you have not realized through sales; and stay focused on your objectives.

Lessons

Over the past few years, we have all witnessed the absolute worst behavior from both investors and the so-called experts on Wall Street. If we fail to learn from this experience, we have missed a golden opportunity. Here are a few to ponder:

This time is <u>not</u> different
Maybe we are in the midst of a technology revolution. Maybe the Internet will change our lives. Maybe there will be a "greater fool" to buy our stocks at even more ridiculous prices. But the laws of economics in this country have not changed. Where there are high profit margins, opportunists will move in and compete and margins will fall. Brand awareness can only take you so far and eventually people have to actually buy what you are selling. You must have continuous high earnings growth to sustain a high stock price.

Price matters
As Jeremy Siegel, the author of "Stocks for the Long Run," recently pointed out in the Wall Street Journal, no large firm, no matter how successful, has ever deserved a P/E ratio of 100 or more. Last March, nine companies were selling at that lofty multiple. One, Cisco Systems, was considered such a sure thing that if you expressed any doubt in the stock price staying high (let alone moving higher) people looked at you like you had three heads. Now I look at them like they have three heads and a few of them weren't working a year ago.

You are your own worst enemy
I get genuinely irritated when I sit down with a prospective client and they tell me that they don't have the time or the inclination to read any of the investment books I recommend. It's not that I don't think they should trust me (they should, but that means they probably trust their stockbroker too), it's more that I know that trust should never substitute for knowledge when it comes to investments. Unless you are a new investor, you have learned a lot already from the school of hard knocks. Information I impart should confirm, reinforce, and build on these lessons and reading unbiased third party support for our principles can often provide the confidence you need to stay with the strategy long-term. Third -party information also helps build the trust that many investors give up far too easily and too early in the relationship.

Wall Street showed its true colors
The most successful investors never blame others for their mistakes. They learn from them and move on. Having said that, however, I believe the last few years will go down in Wall Street history as one of the greediest and unethical of all time. Plain and simply, too many "insiders" took advantage of the market euphoria to redistribute wealth from the pockets of retail investors to their own.

Whether it's Abbey Cohen giving the lame and disingenuous excuse *after the meltdown* that she wasn't directing her constantly bullish comments at "retail" investors, or some dot-commer and his VC buddies selling a story just long enough to pawn the risks off to investors in over-hyped high tech growth funds, they *all* knew it would end badly. Most took huge profits (someone else's money) along the way. I guess it's the American Way, but hopefully investors won't be so foolish next time and actually make these people work for their stock profits by creating real earnings, real products, and real value.

You don't own your unrealized gains
But they can own you if you're not careful. They make you feel richer than you are. You buy a bigger house, fancier cars, and more exotic vacations. Then they go away and you are stuck with more debt and less confidence that the markets will bounce back soon enough.This shouldn't happen if you only spend your *realized* gains.

Diversify
And don't try to time the markets.