



Index Fund Strategies

# ASSET CLASS<sup>®</sup>

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

## Index Returns

	1999	2000	2001	Last 9 yrs.	6/30 2002
<b>Bonds</b>					
Short-term	4.6	6.7	5.8	5.5	1.8
S-T Global	3.7	6.7	5.9	7.3	3.5
Intermediate	-3.6	13.5	8.2	7.1	5.1
Long-term	-7.9	16.6	8.2	8.1	2.6
<b>U.S. stocks</b>					
Large Market	20.8	-9.3	-12.1	13.3	-13.3
Large Value	4.8	10.2	3.8	14.1	-0.2
Small Micro	29.8	-3.6	22.8	14.8	2.8
Small Market	25.4	2.5	12.7	12.6	-4.4
Small Value	13.1	9.0	22.7	15.6	10.4
Real estate	-2.0	28.4	13.2	9.6	13.0
<b>Int'l stocks</b>					
Large Market	28.5	-14.0	-20.8	6.3	-1.2
Large Value	16.3	-0.2	-15.3	8.6	9.0
Small Market	21.9	-5.4	-10.5	3.1	14.5
Small Value	19.0	-3.1	-4.6	3.6	17.0
Emerg. Mkts.	71.7	-29.2	-6.8	5.1	-1.3

### Descriptions of Indexes

Short-term bonds	DFA One-Year Fixed Income fund
S-T Global bonds	DFA Five-Year Global Fixed
Intermediate bonds	DFA Intermed. Gov't Bond fund
Long-term bonds	Vanguard Long-term Bond Index
U.S. Large Market	DFA US Large Co. (S&P 500)
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 9 yrs." returns are ended 12/31/01 and 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 June 30, 2002

You really can't blame the financial media for their obsession with U.S. large growth companies. First we had the wild one-dimensional market of the 90's and now we're faced with the realities of the Enron, Worldcom, and Andersen Consulting debacles. So naturally the focus at quarter-end is the horrible performance of the S&P 500 and NASDAQ indexes. Two and a half years of negative returns. But we know the market is multi-dimensional, right? Small company and large value stocks have performed so much better over the past couple of years that those asset classes have actually surpassed the high flyers since 1995. Diversification does work.

### The Tortoise & The Hare Revisited

Jeff Troutner, TAM Asset Management, Inc.

Does anyone still believe that we will see anytime soon (say, the next 10 years) the kind of returns generated by the technology sector and other large "growth" companies from 1995 to March 2000? Evidently so, because far too many people are hanging on to battered, tech-heavy, large growth weighted portfolios in the hope of a recovery. Instead, these investors should think back to their childhoods to the classic story of The Tortoise and The Hare. In the case of the financial markets today, I think the Hare collapsed at the finish line and won't be back for the next race anytime soon.

Chart 1 shows the total return for various stock categories from January, 1995 to March, 2000. The lead generated by technology stocks over that period was astounding. Keep in mind that this number, +776.1%, represents diversified mutual fund portfolios run by active fund managers. Some individual technology stocks did much better and the Amex Technology Index rose over 900% for the period.

### Chart 1: The Good Hare Days

January 1, 1995 to March 31, 2000 (The "New Era")

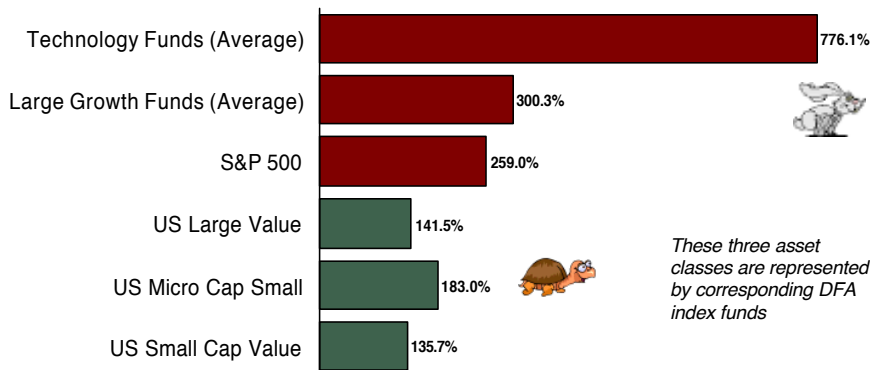


Chart 2 shows what has occurred since March, 2000. It could be argued that the pessimism of the last two years is as overdone as the optimism leading up to the collapse in these stock prices. But the suddenness of the decline in the face of such

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widespread “new era” thinking is likely to produce a “once burned, twice shy” mentality with investors that may not be overcome any time soon.

flowed into hot growth stock funds near the end of this trend. Actually, you don’t have to imagine, you can look it up in the Morningstar mutual fund database. What you will find time and

time again is a small fund plugging along generating decent returns. Then it has one or two *really* good years and the money starts flowing in. Then the bottom falls out. This happens a lot with “sector” funds. A trend develops and builds in technology, biotech, telecom, or whatever. Investors wait for some sign that the trend is “for real” (e.g., Louis Rukeyser has some new “expert” on his show) and then they jump in with both feet right before the fall.

A recent article in *Money* magazine (June 2002) drives home this point. The magazine refers to a paper by an Indiana University

professor and researchers at the Ford Foundation that computed the dollar-weighted results of over 6,900 U.S. stock funds for the period January 1998 - December 2001. The study showed that the average mutual fund shareholder experienced a 1% annualized return at a time when the average U.S. stock fund returned 5.7%.

How can this be, you ask? Well, mutual funds report time-weighted return numbers for performance reasons. This means that money flowing in and out of the fund has no impact on the return. This is the acceptable way to measure the fund *manager’s* performance. But let’s say you invest \$1 in a fund and it grows to \$1.30 over one year and you’re so excited that you put \$5.00 in at the end of that year. Then the fund drops 40% the next year. Your return on the \$6.00 investment was a loss of 37% ( $\$1 + 30\% = \$1.30 + \$5 = \$6.30 - 40\% = \$3.78, \$6 - \$3.78 = \$2.22$  loss,  $\$2.22/\$6 = 37\%$ ), but the fund performance over the period was -22% ( $\$1 + 30\% = \$1.30 - 40\% = \$.78, \$1 - \$.78 = \$.22$  loss,

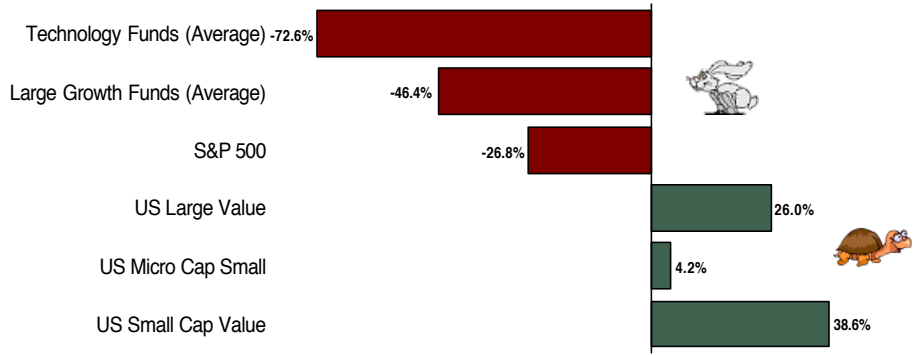
$\$.22/\$1 = 22\%$ ). So the difference between the time-weighted and dollar-weighted returns for a fund indicates that, in this case, a lot of money flowed in when the fund was “hot” and rode it down when the fund cooled off.

The best performing fund in the study, Kinetics Internet, had a time-weighted return of +42.4%, but a dollar-weighted return of -15.8%! In other words, most investors lost money in the fund.

Shifting money to or from hot or cold asset classes, funds, sectors, or markets is a pretty sure way of beating up a portfolio. Diversify broadly, invest regularly, and be patient. Be a tortoise and you will most likely win the race.

## Chart 2: Technology Hits the Wall

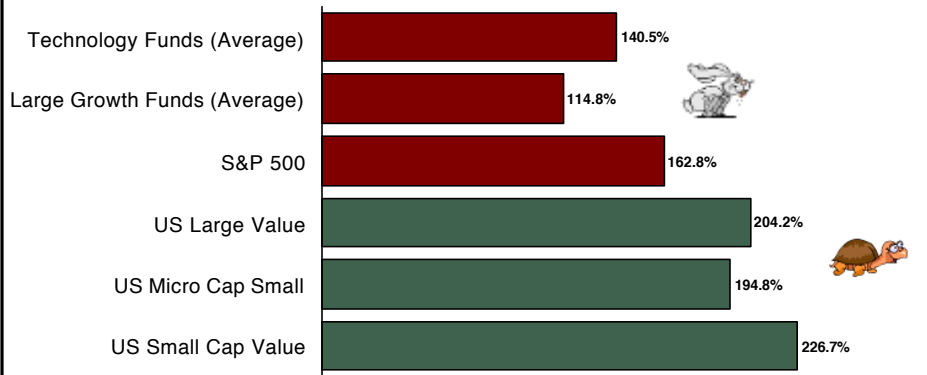
April 1, 2000 to May 31, 2002 (The “New Error”)



It should come as no surprise that we advocate a “tortoise” approach of broad diversification *within* and *among* the large, small, growth, and value asset classes or, for less risk sensitive investors, an all-value portfolio divided among large and small company stocks. Chart 3 shows the advantage of this approach over the full 1995-present cycle— one of the wildest periods in Wall Street history.

## Chart 3: The Tortoise Wins

January 1, 1995 to May 31, 2002 (The Full Cycle)



Of course, this illustration shows only the U.S. side of the equation and during this period the international markets were relatively flat (the big winner was international large value up 47.7%). The benefit of a 30% or 40% international diversification is another issue, but the same principles apply. In fact, we’re starting to see some payoff for owning international stocks this year. The two best performing asset classes so far are international small (+12.8%) and international small value (+15.4%).

This period emphasizes another very important principle of successful long-term investing: Do not shift with the investment winds! Was there ever as “sure” a trend as large growth stock investing in the late-90’s? You can imagine how much money