Index Fund Strategies

ASSET CLASS®

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

Asset Class Returns

	1999	2000	2001	Last 9 yrs.	10/23 2002
Bonds					
Short-term	4.6	6.7	5.8	5.5	2.9
5-Y Global	3.7	6.7	5.9	7.3	7.1
Intermediate	-3.6	13.5	8.2	7.1	10.3
Long-term	-7.9	16.6	8.2	8.1	6.6
U.S. stocks					
Large Market	20.8	-9.3	-12.1	13.3	- 21.1
Large Value	4.8	10.2	3.8	14.1	- 15.2
Small Micro	29.8	-3.6	22.8	14.8	- 17.5
Small Market	25.4	2.5	12.7	12.6	- 22.4
Small Value	13.1	9.0	22.7	15.6	- 13.9
Real estate	-2.0	28.4	13.2	9.6	-3.4
Int'l stocks					
Large Market	28.5	-14.0	-20.8	6.3	- 18.1
Large Value	16.3	-0.2	-15.3	8.6	- 13.9
Small Market	21.9	-5.4	-10.5	3.1	- 2.9
Small Value	19.0	-3.1	-4.6	3.6	0.3
Emerg. Mkts.	71.7	-29.2	-6.8	5.1	- 14.4

Descriptions of Indexes

Short-term bonds	DFA One-Year Fixed Income fund
5-Y 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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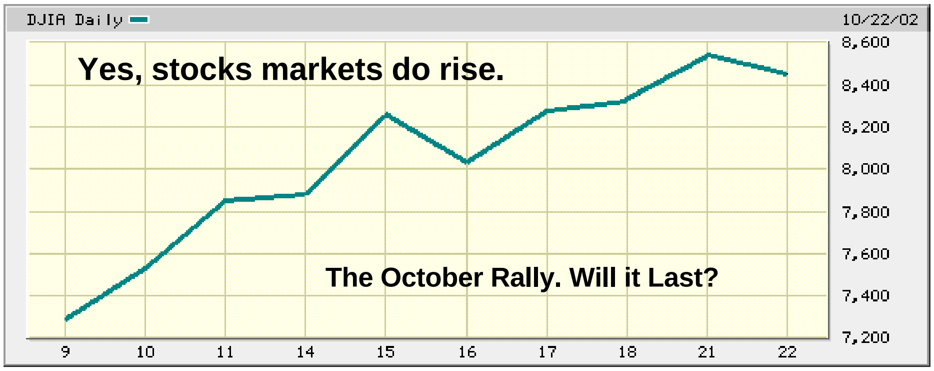


Yes, stocks markets do rise.

The October Rally. Will it Last?

Ten Stupid Things People Do to Mess Up Their Investment Portfolios (cont.)

Jeff Troutner, TAM Asset Management, Inc.

Last month's list of not-too-bright things people do applied mostly to bear markets:

1. **They stop making regular contributions to their investment portfolios.**
2. **They shift from stocks to bonds.**
3. **They extend bond maturities and/or settle for lower quality to gain higher yields.**
4. **They buy fixed annuities.**

Continuing on in a more general vein:

5. **They continue to spend more time planning their summer vacation than learning basic, time-honored investment principles.**

One of the first questions I hear from prospective clients today is, "How did your accounts perform over the past three years?" It's not, "What did I do wrong?!" Or, "How can I keep from doing this again?!"

If there was ever a time to start reading and learning the benefits of asset class diversification, passive investing, dollar-cost averaging, and asset allocation discipline it's now. Otherwise, mistakes will simply be repeated with a new advisor and a new set of securities.

6. **They trust a *person*, not a strategy or investment philosophy.**

This is directly related to #5, since a person who has taken very little time to learn and understand basic investing "truths" is dependent on someone else for this information.

continued on back...

I made the point in a TAM newsletter back in June 1995 that trust *given* instead of trust *earned* can lead to investment disaster (the New Era Foundation and its head, John Bennett, had just been busted for ripping off millions from otherwise "sophisticated" investors). What I meant was that far too many investors hear about a friend's, relative's, or colleague's investment success, ask for a referral, and then are shown some kind of past performance record that seems to confirm that success. The advisor did not *earn* these investors' trust. The investors simply *believed* (trusted) that the advisor would repeat the same level of success for them in the future. Most of the time this type of investor doesn't want to be "bored" with the details of how the returns were produced.

Investors must take time to learn investment basics and trust this knowledge *first*. Only then should they seek an advisor to help them implement and maintain what they already know to be the best long-term strategy for their money. Trust of the advisor will then be built on common knowledge and realistic expectations, not someone else's past performance.

7. They focus too much on the short-term and on individual investments.

This is called "narrow framing" by behavioral finance people. Basically, investors fixate on what's working or not working *now* and lose site of the long range perspective. They also tend to focus on big winners or big losers in their portfolios, rather than on their total portfolios.

Focusing on the short-term past leads to market timing and focusing on individual winners or losers can lead to concentrated, under-diversified, portfolios. During the bull market run of the late 90's many investors put more money in stocks than they normally would have and they tended to concentrate the money in Internet, technology, and telecom stocks. Today, many investors look at the past three years and wonder how anyone in their right mind could own stocks. This is why it's important when developing a long-term strategy to look not only at yearly asset class returns, but also rolling three, five, and ten year returns—and stay diversified.

8. They tend to rewrite history based on future results.

The behaviorists call this "hindsight bias." It seems that investors perceive actions that advisors recommend and that turn out well to have been *inevitable* and those that turn out poorly to have been questionable in the first place.

That's OK—some of us have broad enough shoulders. What you might not want to do is *act* on this bias. I had a few clients that thought diversification was a *very* questionable strategy in the 1999- early 2000 period. I wonder what they think of diversification now.

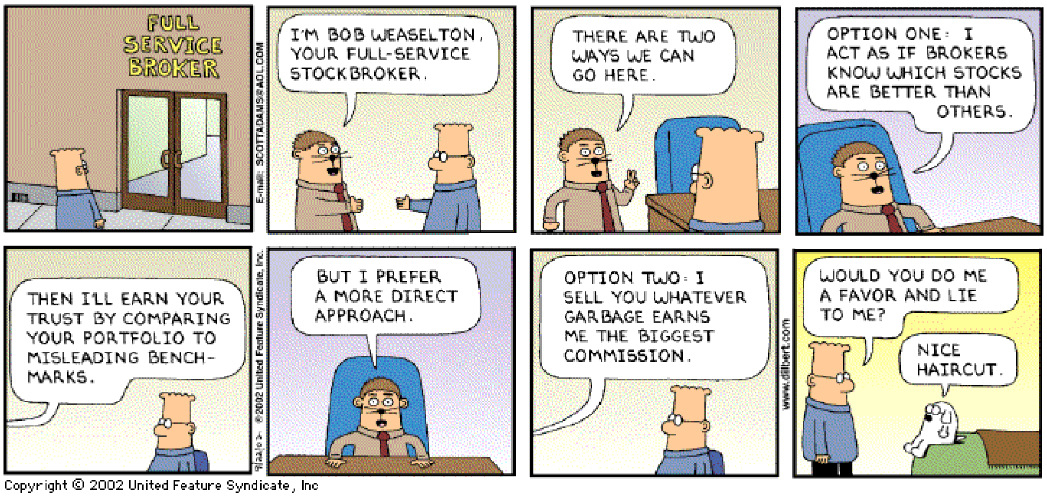
9. They allow "analysis paralysis" to cloud their judgment.

The Fama/French data is pretty impressive with all its formulas, decimal points and "t-stats." But if you think that you can accurately predict the performance difference between simply buying a "total stock market" fund or investing in a diversified asset class portfolio through an advisor, while factoring in the difference between the underlying indexes of the Vanguard and DFA funds, reformulation of fund indexes, varying fund and advisor expenses, the effects of fund level and investor/advisor induced tax strategies, random contributions and withdrawals, periodic rebalancing trades, and the migration pattern of the monarch butterfly, you're just flat out crazy.

Here is the statistic you need to focus on: According to DALBAR, Inc., the difference between the S&P 500 index and the average do-it-yourself fund investor is **10.3%** ***per year*** (and it's not in favor of the investor). DALBAR could be off a few percentage points a year and all that stuff I just mentioned (except for the butterfly migration) becomes pretty trivial.

Past returns data for funds and asset classes is only useful for the big picture: relative risk and return. Sure, you should focus on the details, but don't get lost looking just at the trees. It's still more about discipline, discipline, and discipline.

10. They still go to stockbrokers for "advice."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