EQUIUS
PARTNERS
Adding Balance to Wealth℠

ASSET CLASS℠

An update of performance, trends, research & topics for long-term investors

September 2010

Asset Class Returns

September 30, 2010 (YTD)

	2009	2008	2007	Last 10 yrs.*	YTD 2010
Bonds (%)					
One-year	1.9	4.0	5.2	3.7	1.1
Five-year	4.2	4.0	5.2	4.8	7.1
Intermediate	-0.7	12.9	9.5	6.9	9.5
Long-term	-12.1	22.5	9.2	7.4	18.7
U.S. stocks (%)					
Large Market	26.5	-37.0	5.4	-1.0	3.9
Large Value	30.2	-40.8	-2.8	4.4	6.4
Small Market	36.3	-36.0	-3.1	5.7	11.6
Small Micro	28.1	-36.7	-5.2	6.3	11.6
Small Value	33.6	-36.8	-10.8	9.1	10.2
Real Estate	28.2	-37.4	-18.7	10.5	19.8
International stocks (%)					
Large Market	30.6	-41.4	12.5	1.4	2.1
Large Value	39.5	-46.3	10.2	6.7	2.9
Small Market	42.0	-43.9	5.6	8.7	10.6
Small Value	39.5	-41.7	3.0	11.3	4.9
Emerg. Mkts.	71.8	-49.2	36.0	9.5	12.0

Descriptions of Indexes

Short-term bonds	DFA One-Year Fixed Income fund
Five-Year bonds	DFA Five-Year Global Fixed
Intermediate bonds	DFA Intermed. Gov't Bond fund
Long-term bonds	Vanguard Long-term U.S.Treas.
U.S. Large Market	DFA U.S. Large Co. fund
U.S. Large Value	DFA Large Cap Value fund
U.S. Small Micro	DFA U.S. Micro Cap fund
U.S. Small Market	DFA U.S. Small Cap fund
U.S. Small Value	DFA U.S. Small Value fund
Real Estate	DFA Real Estate Securities fund
Int'l Large Market	DFA Large Cap Int'l fund
Int'l Large Value	DFA Int'l 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 10 yrs." returns are ended 12/31/09.

Equius Partners is an investment advisor registered with the Securities and Exchange Commission. Consider the investment objectives, risks, and charges and expenses of any mutual fund and read the prospectus carefully before investing. Indexes are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio. **Past performance is not a guarantee of future results.**

Equius Partners, Inc.
3 Hamilton Landing, Suite 130
Novato, CA 94949
Phone: 415-382-2500
© 2010 Equius Partners, Inc.

Frozen By Indecision?

Phil Jonckheer, Equius Partners

> Individuals who cannot master their emotions are ill-suited to profit from the investment process.
> *Benjamin Graham*

As Jeff has pointed out in recent *Asset Class* articles, many who call themselves long-term investors have moved dramatically out of stocks and into bonds (primarily). They have done this as expected returns on stocks have *risen*. These speculators are unlikely to re-enter the stock market until expected returns are significantly lower (i.e., when stock prices are significantly higher). Does this make sense? Not to *us* as long-term investors.

What Jeff didn't point out in his articles is how much long-term investment money is sitting on the sidelines, frozen by indecision. Close to 90% of Americans who can are still working and many of them have significantly reduced their expenses. They are accumulating cash, particularly in their 401(k) plans, as they try to make sense of "stimulus" plans that aren't stimulating, tax rates almost certain to rise (particularly on investment gains and dividends), the reality of much higher regulations on big business (particularly banks and investment companies), the threat of even more regulation on small businesses that can hardly afford it, and a general anti-business attitude oozing ominously out of Washington.

Does this hoarding of investment cash make any more sense than what we're seeing with the capitulators who have moved out of the market? Not to *us* as long-term investors.

Missing a Rare Opportunity?

Our overarching objective, as always, is to build a perspective of equanimity and confidence and increase the odds of attaining your long-term financial goals in order to promote your general well-being. We don't know where stock prices will be in six month, a year from now, or five years from now. What we know is that difficult times like these cause expected returns to increase, since future cash flows are discounted more heavily (high discount rates represent those higher expected returns). These are the times when investors exploit speculators and "passive," long-term buy-and-hold investors exploit active investors with short memories.

For all who sit on the sidelines with long-term investment cash, I list a number of behavioral challenges they might be dealing with and offer solutions

Continued on page 2

to their wealth-compromising state (see box on page 3). It's time to take conscious action while the behaviorally challenged are frozen by indecision and lack of confidence. Owners and buyers of markets today are getting the gift of higher expected returns. Those challenged by certain behaviors can't see that.

Facilitating, Not Leading

Stock prices are down from their spring sprouts, and have declined from their October 2007 levels. While those values have no bearing on where stock prices might be heading, both the press and investment advisors have played to investors' fears that naturally surface after market swoons. Here's a sampling of how the press has stirred up the trauma:

> A September 18-19, 2010 *Wall Street Journal* article headline opined that we are victims of a "Bipolar Market" where "...stock and bond markets are swinging daily between optimism and despair. Given all the whipsawing you might be tempted to write the whole thing off and stay in cash."

> Another *Wall Street Journal* article, from September 21, 2010, pronounced, "Slump Over, Pain Persists." The official report just published by the National Bureau of Economic Research pinpointed the end of the recession as June 2009. If the recession ended fifteen months ago but investors are supposedly still in pain, no wonder they feel compelled to be awash in cash.

Making an investment decision based on a press announcement can seriously sabotage your wealth. Consider that the S&P 500 began its recent bull run in March 2009 (it's up almost 70%)— eighteen months before the news of the end of the recession was reported.

Unfortunately a significant number of our colleagues seem to be perpetuating their clients' stress: A Harvard study found that 60% of financial advisors reinforce their clients' bad behavior in order to avoid difficult conversations. By facilitating that behavior, they're exacting a toll far greater than any fee they're charging for their services.

Insights from surveys of investment advisors highlight the inconsistency between advisors' beliefs and their actions: This month, Russell Market Research published a report on investment managers' sentiment. More than half of the managers believed that markets were undervalued. However, according to Russell Research, "Many financial advisors are either being more conservative or reducing risk in client portfolios. Client fear and uncertainly appear to be the primary motivation for this shift." So much for the markets being undervalued! It's not surprising that investment advisors, since they're human, aren't immune to acting irrationally, but given that, we're curious just what service they're providing their clients.

Studies indicate that people reflect five times longer about events that trigger strong negative emotions than they ponder events that stir up strong positive feelings.[1] Bleak economic periods fuel this natural behavioral tendency. There are good reasons for this: Negative events can kill us while positive events merely enhance our well-being. Also, people need to attend to more options when tackling a harmful situation than when coping with good fortune. Negative emotions also flood investors if they hit a brick wall, since the obstacle creates the need for constructing a new plan. If that obstacle triggers a recollection of misfortunes, investors could find themselves re-traumatized.

The human tendency to be affected by information and trade in and out of difficult situations is dramatically reflected in investors' lack of patience: Whereas the average holding period for a stock was about 10 years in 1940, it's now 6 months; for funds it was about 16 years in the 1950s and now it's 4.

So potent are the emotions that affect speculators that a Duke University study found that drops in stock prices were correlated with an increase in heart attacks.[2] We therefore cannot ignore that our behaviors can lead us to compromising our wealth and adversely affecting the quality of our life.

Taking Charge

Constant vigilance for that potentially recurring saber-toothed tiger has been hard-wired into us. As you see after reviewing these behavioral challenges and solutions, more technology and/or information will not make better investors; being aware of our internal decision-making processes will.

Adam Smith, well-known for his book, *The Wealth of Nations*, first published what he considered was a superior work titled *The Theory of Moral Sentiments*, which arguably established him as the first behavioral economist. In that work he postulated that we are responsible for caring for our own well-being and finding a state of tranquility. In more tranquil states, it's much easier to be rational.

---

[1]Aaron Ben-Zeev, "Are Negative Emotions More Important than Positive Emotions?" *Psychology Today*, July 18, 2010

[2]Duke Medicine Staff, "Was the Recent Market Drop Accompanied by More Heart Attacks?" *Science Daily*, March 17, 2010.

Continued on page 3

Challenges	Solutions
We hate to lose. Investors are fundamentally and irrationally averse to losses. After suffering a loss, the fear of an additional loss is so abhorrent that most people shift to some kind of a shut-down mode and stop investing altogether.	**Distract yourself.** To dilute the fear of an additional loss, avoid ruminating on the original loss and engaging in negativity. When people experience negative events, they latch onto negative thoughts. Those thoughts cause one to think through a seemingly endless series of possible disasters.
We take comfort in the herd. If investors perceive themselves to be turning away from the herd, their brain processes a sensation of pain similar to breaking a leg. Today investors are more likely to align themselves with others than ever before: the minutes spent absorbing news has increased almost 25% in the last decade. Also, news is becoming more of a function of friends sharing what they hear/read/see.	**Be a contrarian.** To combat the tendency to herd, step back from the outside stream of opinions affecting the herd and see them for what they are: guesses. More information, even if it's from friends, isn't better information and doesn't transform opinions into facts. Also consider how the information was presented to you and remind yourself that receipt of information does not need to be followed by an action.
We like confirmation. Investors tend to evaluate the validity of an argument not on the basis of logic or facts, but upon whether or not the conclusion is one they choose to accept. This is known as belief bias. A 2007 survey found that two-thirds of the people interested in meeting with a financial advisor were likely to implement advice only if it conformed to their own ideas.	**Open your mind.** To neutralize the belief bias, release yourself from predetermined answers and use facts to lead you to investment solutions. The more beliefs turn into forecasts, the less certain you ought to be of them. At Equius we do not rely on opinions to guide us. We scour evidence-based research to lead us to solutions. To do otherwise will reduce the odds of achieving one's financial goals.
We prefer sound bites. Investors make judgments based on whatever data springs most easily to mind. This is called the availability bias. The press influences this bias by providing data and extensive coverage of unusual events and sparse coverage of routine, less sensational events. Markets drop only 20% of the time but those drops can be violent. This is what makes headlines.	**Turn off the sensationalizing media.** To counter the availability bias, keep in mind that sensational, vivid and easy-to-recall events are less likely to occur than you think. Watch your media diet as carefully as you would your food intake and remember: by the time the press reports on something, good or bad, the marketplace has long ago factored that news into stock prices.
We get emotional. In moments of intense emotion, investors seem to lose all sense of equilibrium. Even with experience, people do not learn to understand or control behavior in heated emotional states. When intuition drives people, emotions are controlling them and they typically start making short-term decisions. That is not investing, it's speculation.	**Keep a cool head.** In order to avoid making decisions in the heat of the moment, take yourself out of the heat. Be vigilant about our tendency to act emotionally and avoid making decisions in that state. My dad always coaxed me never to make a decision when I was furious, sad or elated. Studies indicate that if your heart beat is 10% greater than its average rate, you no longer process information rationally.
We allow ourselves to be victims. When the world presents people with situations that don't seem to make sense, are beyond their control and, worse, punish them unpredictably, they become prone to learned helplessness. If shocks are frequent (and random) investors thrust themselves into a catatonic state of helplessness where inertia takes hold and rational decisions are deferred indefinitely.	**Learn.** The way to break out of the paralysis caused by learned helplessness is to make sense of troubling events and decide how to recover from them. That is why we publish *Asset Class*. Knowledge is not just power, it also controls anxiety and builds the confidence to maintain the discipline required to adhere to your investment plan in the face of challenging times.
We like to gamble. Investors crave the gambling aspect of investing. Ironically, since our brains are hard-wired to release the very additive and pleasure-enhancing dopamine at the mere thought of a reward, the randomness of stock returns keeps speculators addicted to trading. If something is reliable, investors are less attached to it.	**Always think long-term and don't speculate.** To decrease the tendency to seek short-term rewards and to reduce the flow of dopamine in your hard drive, avoid environments where trading is perceived as a solution. Be forewarned: You're fighting a tsunami. There is more information readily available than ever before and when people have more information, they tend to trade more.

Portfolio Snapshot

The information below is for illustration purposes only and shows the asset allocation for a 65/35 balanced asset class portfolio using specific Dimensional funds on September 30, 2010.* This information should not be construed as endorsement or recommendation of a particular portfolio. Such a recommendation should only be made after reviewing specific investor objectives, risk tolerance, and investment time horizon with a qualified investment advisor.

Overview

Total Asset Allocation	Mix
ST Fixed Income	35%
US Equity	45%
International Equity	20%

Regional Allocation	Mix
North America	75.3%
Europe	18.2%
Asia Pacific	6.5%

Country Allocation	Mix
United States	73.0%
United Kingdom	10.3%
Japan	4.3%
Canada	2.3%
Germany	1.5%
Other	4.6%

Equity Sector Allocation	Mix
Financials	23.9%
Consumer Discret.	16.0%
Industrials	15.3%
Information Tech.	9.9%
Energy	9.8%
Other	4.8%

Other	Mix
Weighted Ave. Price-to-Book Ratio	0.98
Weighted Ave. Market Cap (in millions)	29,969
Weighted Ave. Expense Ratio	0.37%

*Mix is 35% DFA 5-Yr. Global Bond, 13.5% DFA US Large Co., 13.5% DFA US Large Value, 18% DFA US Small Value, 12% DFA International Value, and 8% DFA International Small Value. "Market" for US Equity, International Equity, and Fixed Income is the Russell 3000 Index; the MSCI World ex USA Index; and the Citigroup World Government Bond Index 1-30 Hedged (US dollars).

US Equity

Asset Allocation	Mix	Market
Large Growth/Blend	22.7%	51.7%
Large Value	24.9%	18.3%
Medium Growth/Blend	5.7%	14.4%
Medium Value	9.1%	6.2%
Small Growth/Blend	6.4%	5.7%
Small Value	31.3%	3.8%

Sector Allocation	Mix	Market
Financials	22.0%	14.6%
Consumer Discret.	15.7%	11.0%
Industrials	15.0%	11.2%
Information Tech.	12.5%	18.3%
Energy	10.9%	9.9%
Other	23.9%	34.9%

Top Holdings (of 2115 total)	Mix
General Electric	1.7%
Bank of America	1.6%
AT&T	1.4%
ConocoPhillips	1.4%
Comcast A	0.9%
JP Morgan	0.9%
CVS Caremark	0.9%
Exxon Mobile	0.9%
Top 20 Holdings	17.9%

Other	Mix	Market
Weighted Ave. Price-to-Book Ratio	1.1	1.7
Weighted Ave. Market Cap (in millions)	34,736	61,024

Fixed Income

Characteristics	Mix	Market
Duration	3.7	6.3
Yield to Maturity	2.3	1.8
Average Maturity	4.1	8.1
Quality	AA+	

International Equity

Asset Allocation	Mix	Market
Large Growth/Blend	18.4%	53.3%
Large Value	24.0%	14.5%
Medium Growth/Blend	8.3%	14.7%
Medium Value	15.6%	6.9%
Small Growth/Blend	6.2%	6.0%
Small Value	27.6%	4.4%

Sector Allocation	Mix	Market
Financials	28.1%	22.7%
Consumer Discret.	16.8%	10.5%
Industrials	16.0%	12.8%
Materials	14.5%	11.3%
Energy	7.1%	8.8%
Other	17.5%	34.0%

Top Holdings (of 2635 total)	Mix
Vodafone Group	1.7%
Royal Dutch	1.4%
Koninklijke Philips Electronics	0.9%
Daimler AG	0.9%
Top 20 Holdings	14.9%

Country Allocation	Mix	Market
Japan	21.6%	21.4%
United Kingdom	17.8%	18.8%
Canada	10.4%	10.4%
Germany	7.6%	6.8%
Other	42.6%	42.6%

Regional Allocation	Mix	Market
Europe	57.1%	56.1%
Asia Pacific	32.5%	32.8%
North America	10.4%	10.4%

Other	Mix	Market
Weighted Ave. Price-to-Book Ratio	0.9	1.4
Weighted Ave. Market Cap (in millions)	19,323	38,033