



Index Fund Strategies

ASSET CLASS

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

Index Returns

	YTD 6/30	Change From 5/27
Bonds		
Short-term	+2.8%	+0.7%
Intermediate	+2.5%	+1.9%
Long-term	+2.3%	+3.2%
Global	+4.3%	+2.0%
U.S. stocks		
Large Market	+20.5%	+5.0%
Large Value	+15.5%	+4.0%
Small Market	+11.5%	+6.6%
Small Value	+15.6%	+7.9%
Real estate	+5.8%	+5.7%
Int'l stocks		
Large Market	+12.7%	+5.2%
Large Value	+9.2%	+3.2%
Small Market	+3.6%	+1.9%
Small Value	+3.2%	+1.6%
Emerging Mkts.	+13.8%	+7.0%

Short-term bonds = DFA One-Year Fixed Income fund; Intermediate bonds = DFA Intermediate Government Bond fund; Long-term bonds = Vanguard Bond Index Long-term (except first two months of 1994 = 20-yr. U.S. Treasuries); Global bonds = DFA Global Fixed Income fund; U.S. Large Market = Vanguard Index 500 fund; U.S. Large Value = DFA Large Cap Value fund; U.S. Small Market = DFA 6-10 Small Company fund; U.S. Small Value = DFA Small Cap Value fund; Real Estate = DFA Real Estate Securities fund; Int'l Large Market = DFA International Large Cap fund; Int'l Large Value = DFA International Large Cap Value fund; Int'l Small Market = DFA International Small Company fund; Int'l Small Value = DFA International Small Cap Value fund (except 1994 = DFA International Small Company fund); and Emerging Markets = DFA Emerging Markets fund. *Index returns are included for some of the international funds that have not been in existence for three years.

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

Monday, June 30, 1997

Major Markets	Close 6/30	Point change from 5/27	% change from 5/27	% change from 12/31
DJIA	7672.79	+289.38	+3.9%	+19.0%
S&P 500	885.14	+35.43	+4.2%	+19.5%
NASDAQ	1442.07	+32.84	+2.3%	+11.7%
Nikkei 225 (Japan)	20604.96	+715.07	+3.6%	+6.4%

All figures are without dividends reinvested.

The S&P 500 index has risen by an annual rate of 33% over the last two and a half years.

If that statement causes you anxiety, you have too many eggs in one basket. If that statement makes you ecstatic, you have too many eggs in one basket. If it makes you smile contentedly and look forward to the next few years with confidence, your portfolio is probably well-diversified.

According to the experts, we're seeing far too many investors and money managers moving toward S&P 500-heavy portfolios. Active fund managers, as I noted in the last newsletter, are overloading their portfolios with the largest, most liquid stocks in the index. Many market observers see this emphasis on liquidity (the ability to move large blocks of stocks quickly) as an ominous sign that these managers will bail out at the first sign of a market decline.

The article on the back looks at this current "S&P 500 Craze" in a historical perspective. Will this one-dimensional market continue? Look at the record.

For the first time this year, small value stocks have moved ahead of their big brothers (15.6% vs. 15.5%), but both continue to lag behind the S&P 500 (20.5%). Investors are starting to realize that small stocks as a group offer higher growth rates in earnings at lower price/earnings multiples than large stocks.

International stocks continue to move higher, but not at the same scorching pace of U.S. stocks. Value stocks also lag their growth counterparts and we're seeing the same small/large disequilibrium on the international side. The brightest asset class outside of the U.S. continues to be the emerging markets with Mexico leading the way. Below is a ranking of some of the world markets through June 30.

Mexico	32.3%	South Korea	9.2%
Taiwan	26.7%	Australia	8.9%
Spain	19.5%	Japan	7.9%
U.S.	18.7%	France	7.0%
Germany	15.0%	U.K.	5.6%
Italy	14.2%	Singapore	-11.3%
Canada	10.7%	Malaysia	-14.5%
Hong Kong	10.5%	Thailand	-33.1%

Source: Dow Jones World Stock Indexes; U.S. dollar terms.

Keeping the S&P 500 Index In Perspective

No one in the investment business foresaw the incredible growth in S&P 500 index fund assets that has occurred over the past few years. This growth has been the direct result of the superior performance of the stocks of the largest corporations in the U.S.—the major components of the index.

The financial media and active management community, as usual, continue to focus almost exclusively on the S&P 500 when referring to indexing in general. At the same time they're getting pummeled by the index, active managers are warning of the exposure "indexed" investors have to an inevitable decline in large cap growth stocks. If most "indexed" investors have the majority of their assets in the S&P 500 index funds, their conclusion might be right. But active management is not the answer. And the arguments these managers make in defense of their "style" are often ridiculously weak.

For example, we're told that active funds won't fall as far in a market decline because of the 5%-10% cash "cushions" many of the funds maintain. Of course this cushion hurt on the way up, but, never mind, we're talking about the future here. Managers also use data on past down years to show active management's advantage. As usual, however, they fudge the numbers a bit. In 1990 when the S&P 500 fell 3.2%, the Vanguard 500 fund beat over 60% of domestic equity funds. In 1987 when the market crashed, the Vanguard fund outperformed 70% of these funds.

Faced with these facts, active managers often cite the 1981 and 1977 down market data to support their case. According to one study, 63% of active managers beat the S&P 500 in 1981 and 85% beat it in 1977. Wow. Either these managers had some serious cash cushions or they made a lot of very good stock picks. Or maybe not.

In 1981, the S&P 500 fell 4.9% and the largest 10% of U.S. stocks fell 8.2%. But the other 90% averaged a gain of 2.5%. Since the portfolios of active managers have a much lower average market capitalization than the S&P 500, you should expect them to outperform that index during periods when smaller stocks outperform. In 1977, the numbers were even more dramatic. The largest 10% of stocks fell 8.6% while the smallest 10% rose 30.7%!

Far from making the case for active managers, these numbers do emphasize the importance of diversifying beyond the S&P 500. The table below shows the rolling 5-year returns for small company, S&P 500, and international stocks and their value counterparts since 1969. The S&P 500 was never the best performing market (shaded) out of the 24 periods. You will also notice that an asset class tends to outperform for long periods of time and that the value asset classes dominate consistently.

Let the mass media and active managers focus on the S&P 500. I'll take a diversified value-indexed portfolio any day.

Best Performing Asset Class Over Rolling 5-Year Periods (%)

5-Yr. Periods	Small Value U.S. Stocks (Value Index)	Small U.S. Stocks (DFA 6-10 Index)	Large Value U.S. Stocks (Value Index)	S&P500	Large Value Int'l Stocks (Value Index)	Large Int'l Stocks (EAFE)
69-73	-7.4	-11.9	3.0	2.0	N/A	7.4
70-74	-5.7	-12.8	1.4	-2.3	N/A	1.6
71-75	2.7	-2.2	7.8	3.2	12.6	10.6
72-76	9.0	2.0	14.0	4.9	8.0	5.5
73-77	11.8	4.9	10.9	-0.2	7.3	2.6
74-78	23.6	19.1	12.9	4.3	18.7	12.2
75-79	37.2	36.5	24.0	14.8	25.9	19.3
76-80	32.3	32.8	17.6	13.9	20.0	17.1
77-81	23.9	23.4	11.5	8.1	21.5	16.0
78-82	27.0	24.2	16.9	14.0	15.3	11.7
79-83	31.3	26.3	21.0	17.3	13.5	10.1
80-84	24.4	16.8	19.0	14.8	14.2	10.4
81-85	25.4	15.6	21.5	14.7	22.5	15.6
82-86	26.9	16.8	23.5	19.9	32.8	28.8
83-87	17.5	10.0	18.2	16.5	39.5	34.9
84-88	14.8	9.1	17.8	15.4	39.9	35.8
85-89	17.9	13.5	20.6	20.4	44.1	36.5
86-90	6.0	3.3	11.1	13.1	25.7	18.4
87-91	9.8	9.9	12.8	15.4	15.7	9.0
88-92	17.2	15.7	16.7	15.9	8.8	1.7
89-93	16.6	14.2	15.9	14.5	11.0	2.3
90-94	12.8	10.9	9.2	8.7	8.0	1.8
91-95	24.4	22.0	20.1	16.6	14.2	9.7
92-96	21.2	17.0	18.3	15.2	13.3	8.5