



TAM ASSET MANAGEMENT, INC.

ASSET CLASSSM

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

Asset Class Returns

March 17, 2004

	2001	2002	2003	Last 10 yrs.	2/29 2004
Bonds					
Short-term	5.8	3.9	1.6	5.0	0.4
Five-Year	5.9	10.4	3.0	6.8	1.8
Intermediate	8.2	15.0	2.5	6.9	2.4
Long-term	4.3	16.7	2.7	7.7	3.7
U.S. stocks					
Large Market	-12.1	-22.2	28.5	10.9	3.2
Large Value	3.9	-14.9	34.4	12.1	4.3
Small Micro	22.8	-13.3	60.7	14.8	6.3
Small Market	12.7	-19.1	51.5	12.2	5.4
Small Value	22.6	-9.3	59.4	15.6	6.4
Real estate	13.2	4.2	35.6	10.8	6.0
Int'l stocks					
Large Market	-20.8	-14.6	36.7	4.9	3.6
Large Value	-15.3	-8.5	49.4	7.0	5.6
Small Market	-10.5	1.9	58.8	4.8	8.7
Small Value	-4.6	5.8	66.5	6.1	9.4
Emerg. Mkts.	-6.8	-9.4	60.2	2.3	6.3

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 US Large Co. fund
U.S. Large Value	DFA Large Cap Value fund
U.S. Small Micro	DFA US Micro Cap fund
U.S. Small Market	DFA US Small Cap fund
U.S. Small Value	DFA US 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 12/31/02 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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“Trust Me”

Jeff Troutner, TAM Asset Management, Inc.

The underlying causes for the recent Wall Street scandals were driven home recently by a presentation I participated in with Gordon Murray, a consultant to Dimensional Fund Advisors (DFA) and 27-year veteran of Wall Street. Gordon had been employed at high level institutional sales and management positions with firms like Goldman Sachs, Lehman Brothers, and Credit Suisse First Boston (CSFB) and he provided a rare look behind the scenes. It wasn't a pretty picture.

The objective of the presentation was not to bash what some may perceive as our competition, but rather to put a real face and real stories to all of the recent scandals that tend to be glossed over by the mainstream press. Our objective for the presentation is best summed up in three words: “Forewarned is forearmed.”

Those who attended the event and are familiar with our investment approach recognized the contrast between the firms Gordon mentioned and the firms we choose to work with (please see the November 2003 *Asset Class* article entitled, “It’s the Culture”). Those who attended and are new to our approach received a dose of reality that may have been a little (or a lot) shocking. We can only hope that they recognize the beginning of a process toward rational investment expectations.

As I’ve mentioned before, it is a sad fact that most investors spend less time trying to understand investment alternatives and monitoring outcomes than they do planning their summer vacation. And most investment professionals, responding to the “sound bite” attention span of most investors, figure on spending maybe one hour convincing a potential client of the merits of their program. Naturally, past performance, unique “talents,” how many initials are after their name, or how many degrees they possess become the focus of too many of these presentations. The implication is “Trust me. I’m good enough, I’m smart enough, and doggone it, people like me.”

This is where trust *given* instead of trust *earned* can lead to investment disaster. Trust is given daily to stockbrokers, bankers, financial planners, and insurance agents based on referrals from friends, other trusted advisors, or a brother-in-law. At the height of the stock market mania in the late '90's, it wasn't uncommon to get a referral from a hairdresser or mail carrier.

I recall my first years in the investment business were spent trying to convince corporate retirement plan sponsors that the term bank “trust department” was an oxymoron. “Trust” often translated into very low returns, little real management, and lousy service. Few were willing to consider prudent alternatives, especially from a twenty-something broker challenging the intentions of a fifty-something banker.

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Today, bank trust departments control a much smaller piece of the retirement plan and personal trust markets, but they have redirected their attention to selling high-fee mutual funds and variable annuities to easy prey looking for “higher yields.” Our challenge now has shifted to convincing investors that the benefits of indexing and asset class investing are superior to active strategies. We have to admit that the spectacular market slide over the three years ended last March has made the challenge easier for us, but old habits die hard. The question is, why?

I think the answer lies in the fact that most investors simply follow the crowd. In the 60’s and 70’s “smart” investing meant putting your money in a bank trust department. In the 80’s and 90’s it was considered “smart” to hire a money manager with a billion dollars under management, fancy credentials, and a recent history of beat-the-market performance. In the late 90’s investors were flocking to place their retirement nest eggs with twenty-something high school dropouts with nose rings and pierced navels managing the hot Internet funds.

What investors fail to realize is that investment advisors are the worst crowd-followers of all. Roger Lowenstein, in a Wall Street Journal article entitled, “Why Gurus Weren’t Wise to New Era’s Wiles” writes: “This is the dirty little secret of experts. Outsiders view them with awe, particularly when their field is an abstruse one such as investing. But in truth, experts are courageous or impressionable, independent or conventional, in the same degrees as other two-legged beasts. And all of an expert’s brains and training will not count for much if, at the crucial moment, he relies on somebody else’s brains instead of his own.”

Lowenstein refers to a study by Robert J. Shiller, a Yale scholar, who polled 1,000 investors—both professional and individuals—after the 1987 market crash. Shiller found that the pros had been far more irrational of the two: “While individual investors mostly remained calm, the pros, hired for their supposed expertise, admitted to a ‘contagion of fear’, with attendant symptoms such as sweaty palms, rapid pulse rates and tightening of the chest. They checked their screens-checked to see what others were doing-an average of 35 times a day.”

Lowenstein concludes that this is why 70% of money managers are estimated to be crowd following momentum players. Quoting Mr. Shiller, he states: “All our lives, we work under the assumption that what other people do must be right...because they must know something.”

If passive investing has done anything, it has focused investor attention on the realities of the financial markets and the uncertainties of active strategies and fund/manager selection services. It has shown that trust in manager’s judgment over an understanding of market principals and one’s

personal objectives will almost always lead to disappointing results.

Passive investing has shifted power from the pros to the investor. And it has redefined the role of advisors like TAM, which is to extract the most dangerous element of investing—emotion—from the equation and keep clients well-informed at all times. This combination of a well-informed and rational investor with a non-crowd following and disciplined advisor finally realizes the full potential of a free market.

An important part of Gordon Murray’s message was that government regulators and Wall Street executives are not going to fix the problems of greed, fiduciary mismanagement, and self-dealing that are rampant in this industry. The solution lies with informed investors who reject the marketing facades, have self-educated themselves to some degree, and take control of their financial destinies.

Trust has an important place in an investment relationship, but only after that trust is *earned* by an advisor who first *affirms* and then properly *executes* and *maintains* the course the investor already knows is the right one.

¹In this case, Lowenstein is referring to the massive fraud perpetrated by John Bennett in 1995 at The Foundation for New Era Philanthropy. But he could be referring to the “new era” investors at the peak of the market bubble as well.

This article is an update of one I wrote in June, 1995.

Excerpts from John R. Emshwiller's article, “Plucking Pigeons: Why the Wealthy Are Often Targets of Fraudulent Deals”, in the May 16, 1995 issue of *The Wall Street Journal*. (Note: This was in response to The Foundation for New Era Philanthropy fraud.)

There is often an “arrogance that comes with having money or having made money”, says Irving Einhorn, a former top official with the Securities and Exchange Commission and now an attorney in Los Angeles. Mr. Einhorn says he has repeatedly seen a certain mind-set among the successful and those who manage their money. “Their feeling is that ‘because I make a lot of money, I must be smart’”.

The social and business networking that the wealthy often engage in can make them more susceptible to being defrauded, experts say. “If a business opportunity comes through someone they trust, there is a presumption that due diligence has been done when it really hasn’t”, says James BN. Hunt, national practice leader for Price Waterhouse’s investigative services group, which specializes in cases involving white-collar crime.

The wealthy also are susceptible to a roller-coaster psychology: They may be initially skeptical, but once the gang climbs aboard, they don’t want to be left behind. “It happens that a friend makes some money, and based on that small success 30 other friends go in big-time”, says Einhorn, the former SEC official. “They just throw caution to the wind.”