TAM ASSET MANAGEMENT, INC.

ASSET CLASS℠

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

Asset Class Returns

	2001	2002	2003	Last 10 yrs.	12/31 2004
Bonds					
Short-term	5.8	3.9	1.6	5.0	0.9
Five-Year	5.9	10.4	3.0	6.8	2.9
Intermediate	8.2	15.0	2.5	6.9	4.3
Long-term	4.3	16.7	2.7	7.7	7.1
U.S. stocks					
Large Market	-12.1	-22.2	28.5	10.9	10.7
Large Value	3.9	-14.9	34.4	12.1	18.3
Small Micro	22.8	-13.3	60.7	14.8	18.4
Small Market	12.7	-19.1	51.5	12.2	17.8
Small Value	22.6	-9.3	59.4	15.6	25.4
Real estate	13.2	4.2	35.6	10.8	32.1
Int'l stocks					
Large Market	-20.8	-14.6	36.7	4.9	18.8
Large Value	-15.3	-8.5	49.4	7.0	28.8
Small Market	-10.5	1.9	58.8	4.8	30.9
Small Value	-4.6	5.8	66.5	6.1	34.8
Emerg. Mkts.	-6.8	-9.4	60.2	2.3	29.9

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 12/31/03 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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If Only Investors Were *More* Like Lemmings

Jeff Troutner, TAM Asset Management, Inc.

I have been picking on lemmings my whole investment career. I, like many people, believed that lemmings experience periodic population booms that result in irrational, zombie-like suicide marches off of cliffs. So, naturally, I have thought of lemmings as I have observed investor behavior in the past.

Well, the lemming march is a myth[1] . These cute, furry, little rodents do occasionally get a bit randy and reproduce at extraordinary rates. But rather than forming herds and reacting to their overcrowded conditions by jumping off cliffs en masse, most simply roll over, have a cigarette, and decide to move to a different location in search of more food, shelter, and privacy.

If only investors were more like lemmings. Periodically, investors get real excited themselves. But rather than exhibit the healthier and more satisfying behavior of lemmings, they temporarily abandon their spouses and children, hunker down with their trusty computer, Wall Street analysts' reports, and their $9.95 trade commissions and proceed to follow a herd of like-minded investors right off the cliff. Some survive, brush themselves off, reconnect with family and friends, and discover the simple beauty of asset class diversification. Most, alas, line up for the next cliff.

One of the Greatest Learning Experiences—Ever

The past seven years or so represents one of the most volatile periods in U.S. stock market history and one of the most uncertain social, political, and economic times ever. It should serve, therefore, as one of the greatest learning experiences for investors. Unfortunately, rather than looking back and seeing familiar patterns that confirm a set of basic, time-honored investment principles—as I do—too many investors see only chaos and react in kind by migrating to "alternative investments" and engaging in market timing behavior. Proactively rebalancing more diversified portfolios rather than setting themselves up for the next big investment mistake would be more like the lemmings rebalancing their populations by moving rather than committing mass suicide. A much more rational decision.

The stock market is volatile and unpredictable. In the short-run stock prices reflect the emotions and short-term expectations of the moment. Over the long-run, stock prices reflect the general growth in the underlying economy. And good economic growth—as well documented by my friend Bill Bernstein in his book, *The Birth of Plenty*—is more likely to occur in a society that places great value on personal property rights, scientific rationalism, well-developed capital markets, and fast and efficient communication and transportation. Americans enjoy all these advantages. So why are we driven to jump in and out of capital markets and seek alternatives to stocks when markets don't act the we want them to? Dr. Bernstein gives us a clue in Chapter 1 of his book:

> *It's all too tempting to lament the state of the world, particularly when you focus on the melodramas of mankind—violent conflicts, large-scale malfeasance and failure, and the latest installments in the age-old racial and religious hatreds that permeate the human story.*

continued on back...

A paragon of such fashionable pessimism has been journalist Anthony Lewis, who, at the end of a long and distinguished career, was asked whether the world had gotten to be a better place since he had begun covering it a half century earlier:

"I have lost my faith in the ideal of progress. I mean that in the sense that it was used at the beginning of the twentieth century, that mankind is getting wiser and better and all—how, how can you think that after Rwanda and Bosnia and a dozen other places where these horrors have occurred?"[2]

Mr. Lewis' problem is that his subjective criterion—that mankind has not achieved moral perfection as defined in Ivy League universities and the editorial suites of the New York Times—sets the bar too high. Mr. Lewis seems unaware that we can measure the welfare of mankind; in fact, we can do it superbly. Contrary to his gloomy impressions, the second half of the twentieth century was far less murderous than the first. Further, the proportion of the world's population subjected to totalitarianism, genocide, starvation, war, and pestilence has been steadily decreasing over the past two centuries, with most of the improvement coming in the half century that so depressed Mr. Lewis.

The stock market is not a place for pessimists. The late 90's also demonstrated that it can be a hostile place for overly exuberant optimists. I think what *The Birth of Plenty* does very well (along with Bill's equally well-written book, *The Intelligent Asset Allocator*) is to help create stock market *realists*—what I would define as reasonably optimistic investors with rational expectations.

A reasonably optimistic investor with rational expectations accepts stock market volatility as a constant reality, rejects "bullish" and "bearish" emotions, diversifies broadly among asset classes with long histories of favorable risk/return characteristics, accepts "passive" investing as the odds on favorite to beat "active" management over time, controls investment costs, and avoids market timing like the plague. These investors should also run, not walk, from advisors who do not share these beliefs.

It's a Total Package

I believe it's critical as well for long-term investors to adhere to all of these principles *as a package*. You can't pick and choose among them to suit a particular mood or a particular investment advisor's style.

For example, many investors discovered "indexing" in the late 90's, but invested all of their stock allocation to an S&P 500 or Total Stock Market fund. These indexes are still down from the 1999-ending values five years later. ***Good move: Indexing; Bad move: Overconcentration in one asset class.***

An investor recently called to say that he had moved his DFA-based indexed portfolio to an "ultra-low cost" advisor in 2003 only to find that the advisor has maintained a decidedly "bearish" stance for the past couple of years. He convinced the investor to stay out of stocks for the most part until "economic conditions improve." ***Good moves: Indexing, DFA funds; Bad move: Put cost ahead of sound investment principles and hired a market timing advisor (probably without knowing it).***

I am also getting a lot of calls from prospective clients asking my views on real estate investment trusts, gold, commodity funds, hedge funds, and other alternative investments. Clearly, some investors are in an "anti-stock" mood that is most likely not in their long-term interests. These calls take me back to my early days as a stockbroker in the early 80's when real estate limited partnerships, gold coins, commodity futures trading accounts, and "managed money" were the hot sellers. Those sure worked out well.

Once the core investment principles are understood and *accepted*, consistency of their application is critical to long-term success. I'm proud to say that has been my policy at TAM since its founding in 1992. With the exception of adding new funds, such as the DFA value funds in 1993 & 1994, my asset allocation philosophy has not changed. I don't get bullish or bearish (and adjust allocations as a result) and I don't add alternative investments to the mix because existing or prospective clients "demand" them.

TAM clients are not immune to the emotions of investing, and the anxiety many felt as their small-cap and value tilted portfolios lagged in the late 90's was palpable. But as the table below shows, adhering to sound principles has its rewards..

	Total Return Since	
Bonds	**Market Peak April 1, 2000**	**9/11 Terrorist Attacks October 1, 2001**
DFA 5-Yr. Global Fixed	30.4	17.1
US Stocks		
Vanguard 500 Index	**-13.6**	22.4
DFA US Large Value	60.4	51.4
DFA US Micro Cap	61.3	100.1
DFA US Small Value	122.8	117.4
Foreign Stocks		
DFA Int'l Large	**-4.7**	47.8
DFA Int'l Large Value	57.5	85.0
DFA Int'l Small	72.5	116.2
DFA Int'l Small Value	120.0	141.7
DFA Emerging Markets	29.1	132.0

Past performance is no guarantee of future returns. Always review the prospectus before purchasing any mutual fund.

[1]The lemming myth is evidently based on a 1958 Walt Disney movie titled *Wild Wilderness*. To view clip of the animated short film *Lemmings*, which was produced by BYU students, go to: http://magazine.byu.edu/article.tpl?num=03.23-win04

[2]"Conversations, The Long View; Covering 50 Years of War, Looking for Peace and Honoring Law," New York Times, 16 Dec. 2001.