TAM ASSET MANAGEMENT, INC.

ASSET CLASS[sm]

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

Asset Class Returns

May 31, 2006 (YTD)

	2003	2004	2005	Last 10 yrs.	YTD 2006
Bonds					
Short-term	1.6	0.9	2.3	4.3	1.7
Five-Year	3.0	2.9	1.7	6.1	0.7
Intermediate	2.5	4.3	1.6	6.2	-1.2
Long-term	2.7	7.1	6.6	7.1	-5.4
U.S. stocks					
Large Market	28.5	10.7	4.9	8.9	2.6
Large Value	34.4	18.2	10.2	11.9	7.2
Small Micro	60.7	18.4	5.7	13.6	7.2
Small Market	51.5	17.9	6.1	11.8	7.9
Small Value	59.4	25.4	7.8	15.9	11.1
Real estate	35.6	32.1	13.2	15.1	7.7
Int'l stocks					
Large Market	36.7	18.8	13.5	6.2	10.2
Large Value	49.4	28.8	15.3	9.2	13.2
Small Market	58.8	30.9	22.0	N.A	10.5
Small Value	66.5	34.8	23.2	10.2	11.7
Emerg. Mkts.	60.2	29.9	29.9	8.5	3.7

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 12/31/05.

TAM Asset Management, Inc. 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.

Past performance is no guarantee of future results.

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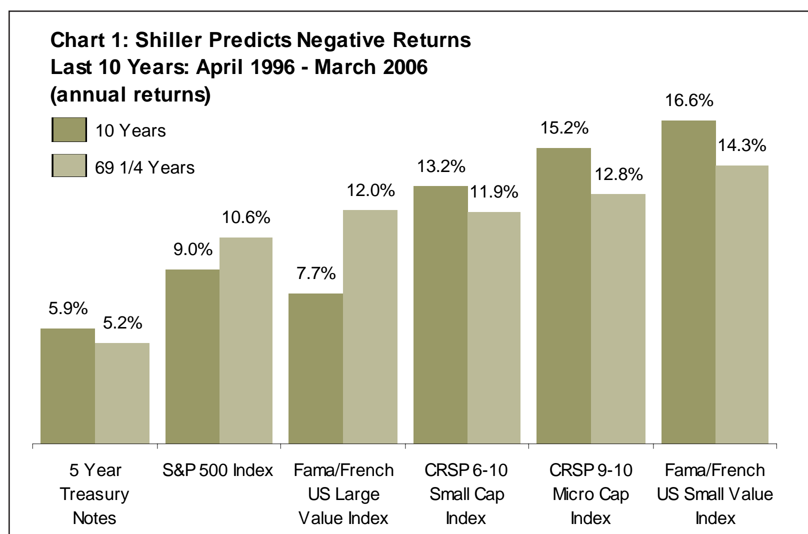
Asset Class Returns: 10 Years Later

Jeff Troutner, TAM Asset Management, Inc.

> *"Looking at the diagram, it is hard to come away without a feeling that the market is quite likely to decline substantially in value over the succeeding ten years; it appears that long run investors should stay out of the market for the next decade."*
>
> **Robert J. Shiller, Ph.D; July 1996** [1]

We now have ten years behind us since the Yale professor and market expert (and Federal Reserve chairman Alan Greenspan) warned us all of "irrational exuberance" in the U.S. stock market. Most investors know that the exuberance continued unabated for almost *four more years* before stock prices came tumbling down starting around the second quarter of 2000. But most investors, if asked, would probably say that Shiller was correct in his prediction. This opinion is reinforced by the fact that Shiller's book, *Irrational Exuberance* was published in 2000 (perfect timing!) and went on to become a bestseller.

But did Shiller's prediction really come true? And what about all those other experts (including some investment advisors who use the DFA and other index funds to build client portfolios) who predicted very low and even negative returns for stocks since the late 90's? Let's look at the record.



Not only was Shiller wrong, but the returns for the past ten years are very similar to the long-term averages. In fact, the returns of small cap stocks *exceeded* the long-term averages during this period of "low expected stock returns."

The Past 6 Years

Now let's look at asset class returns since the stock market "bubble" burst. Returns on large company stocks have not provided a "risk premium" over short-term fixed income

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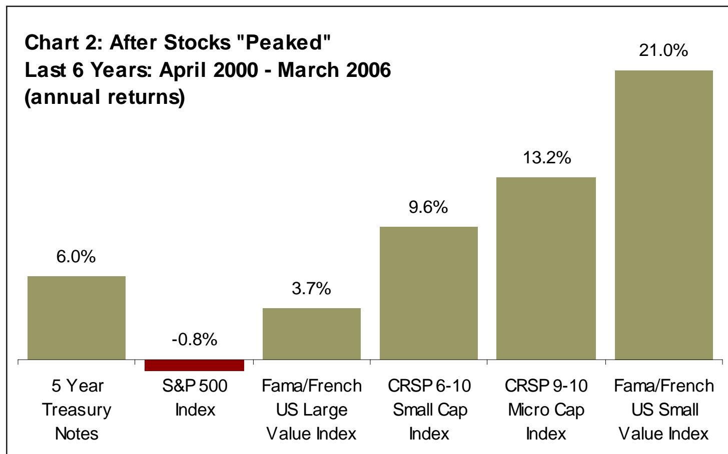
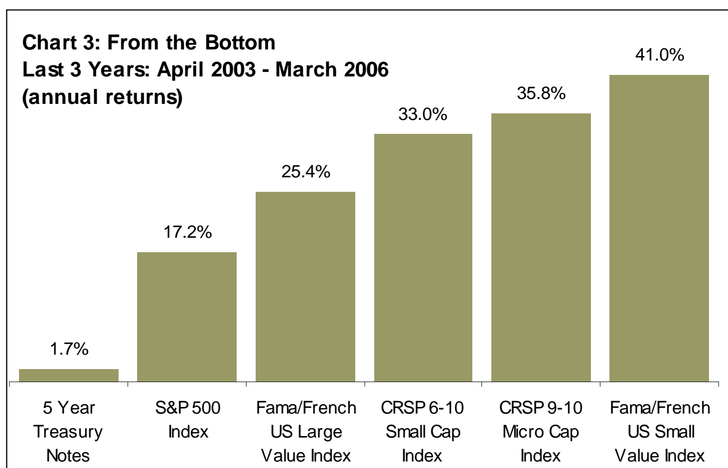
investment since April 2000, but small cap stocks have performed well beyond the expectations of most experts.



If P/E ratio analysis and expected return calculations could help us with timing decisions, they might have some practical value beyond preparing investors emotionally for periods of lower returns in certain asset classes. But they don't. Only with 20/20 hindsight can we see March 2000 as the starting point for the stock market decline. Shiller and Greenspan were warning of irrational exuberance four years previous and many reputable financial experts have been predicting very low or even negative returns every year since the market peak.

The Past 3 Years

A funny thing happened while all the doom and gloomers were scaring investors away from stocks and into fixed income and "alternative investments": U.S. companies were still selling goods and services and earning profits. And what followed were higher stock prices across the board.



The last 3 years (Chart 3) has been a truly stellar period for stocks and it's safe to say that no one predicted it.[2] Unfortunately, far too many long-term investors have not realized anything near these returns—not because they weren't in good index funds (although that's certainly a factor), but because they weren't in the market at all or significantly reduced their equity allocations based on all the expert predictions of very low (or negative) equity returns.

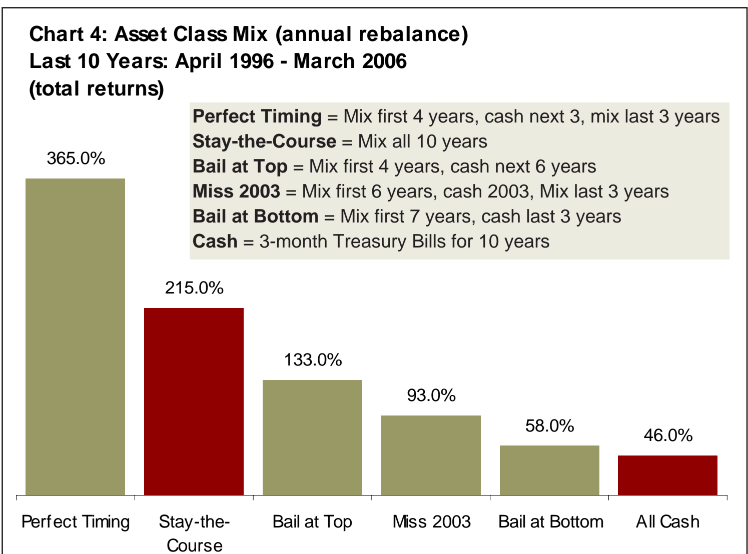
Keep in mind that over the *previous* three years (April 2000 to March 2003) the S&P 500 fell by over 40% (the last quarter being particularly brutal). Based on Shiller's and many other experts' predictions and the horrible returns during these three years, many investors thought the big stock party that started in 1982 was over.

And talk about kicking these market timers when they're down, most of the recovery in stock prices from that period occurred over the next *twelve months* (typical market behavior, by the way[3]).

What Have We Learned?

Indexing has brought a highly structured, researched-based discipline to long-term investing. But it's also introduced a degree of mathematical and statistical minutia that can lull investors (and far too many advisors) into a false sense of certainty. I'm convinced that the conclusions drawn from simple mathematical models have caused millions of investors to miss huge opportunities to build their financial wealth and, in too many cases, squander wealth through market timing mistakes.

For another perspective, let's look at Chart 4, which shows the returns for an asset class mix of 30% S&P 500, 30% Large Value, 20% Micro Cap, and 20% Small Value using the indexes from the previous charts.



The lesson seems clear to me: Since "perfect timing" is unachievable except by pure luck, investors and their advisors are better off reading papers or books on "expected return" models in order to prepare themselves mentally for what *could* happen, while maintaining a strict buy-and-hold portfolio structured to meet their *long-term* objectives. Rebalancing to target allocations (once a year is usually sufficient) is a much more rational strategy to follow *and* it requires very simple mathematical skills.

This approach also allows us all to focus our energies on what's really important (and productive) in our lives as we seek that elusive balance of wealth, work, and values.

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[1] Robert J. Shiller, *Price-Earnings Ratios as Forecasters of Returns: The Stock Market Outlook in 1996.*

[2] Notwithstanding my January 27, 2000 *Asset Class* article titled, *Should We Fear a Total U.S. Market Collapse? Or is a gradual "rotation" among asset classes more likely?*

[2] Professor H. Nejat Seyburn, *Stock Market Extremes and Portfolio Performance: 1927-2004*