EQUIUS PARTNERS
Adding Balance to Wealth℠

ASSET CLASS℠

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

April 2011

Asset Class Returns

March 31, 2011 (YTD)

	YTD 2011	Last 10 yrs.*	2010	2009	2008
Bonds (%)					
One-year	0.2	3.1	1.2	1.9	4.0
Five-year	0.3	4.6	5.3	4.2	4.0
Intermediate	0.0	6.3	6.9	-0.7	12.9
Long-term	-1.1	7.1	8.9	-12.1	22.5
U.S. stocks (%)					
Large Market	6.0	1.3	14.9	26.5	-37.0
Large Value	9.3	5.3	20.2	30.2	-40.8
Small Market	8.7	8.3	30.7	36.3	-36.0
Small Micro	8.1	9.6	31.3	28.1	-36.7
Small Value	8.8	11.1	30.9	33.6	-36.8
Real Estate	6.6	10.5	28.7	28.2	-37.4
International stocks (%)					
Large Market	3.8	3.9	9.3	30.6	-41.4
Large Value	4.7	7.8	10.6	39.5	-46.3
Small Market	4.1	11.7	23.9	42.0	-43.9
Small Value	5.6	13.5	18.1	39.5	-41.7
Emerg. Mkts.	2.0	15.6	21.8	71.8	-49.2

Descriptions of Indexes

One-Year 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 Market	DFA U.S. Small Cap fund
U.S. Small Micro	DFA U.S. Micro 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 12/31/10.

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.**

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Investing and the Media

Jeff Troutner, Equius Partners

Like Pogo, the investment industry (ourselves included) is fond of pointing out that investors are their own worst enemies. In fact, we've written numerous *Asset Class* articles over the years outlining the costly behavioral traps investors fall into over the course of their investing lives—including hiring active money managers or buying actively managed mutual funds. But are investors really their own worst enemies, or is this an unrealistically harsh judgment given the impact of the media in shaping our views and behavior?

I've thought a lot about this recently in light of 1) the apparent growing acceptance of indexing by investors, 2) the increasing desperation of active managers to justify their existence, and 3) the still incredibly rare pro-indexing articles we find in the mainstream and financial press. It's this latter observation that is the theme of this article, but before I get into that, let's consider the first two points.

The Growth of Indexing & Desperate Advisors

According to the Investment Company Institute, index fund assets have grown from 10.5% of total stock mutual fund assets ten years ago to almost 25% today. Overall, that's good news. Despite an overwhelming bias (in terms of sheer volume) in the press for articles on stock picking and market timing tips and schemes, someone is hearing the indexing story and embracing it.

But the news isn't as good as it appears at first glance. A great deal of the growth in index funds has come in the form of exchange-traded funds (ETFs) that brokers, advisors, and individual investors are using to jump in and out of markets, asset classes, industry sectors, and commodities. Therefore, all the advantages of indexing, including lower costs, broad diversification, fewer tax consequences, and greater return predictability, are more than wiped out by short-term speculative foolishness.

Thousands of advisors, who long ago convinced themselves and their ever-changing clientele of their intellectual superiority over "the market"—only to be consistently humbled by it—have shifted their strategies from individual stock picking to ETF picking with a market timing overlay. That's right. They've doubled down on what consistently fails for long-term

Continued on page 2

investors, while also holding themselves out as proponents of "indexing." Marketing creativity at its destructive best.

As I pointed out in last month's *Asset Class*, we're also reading about prominent active managers using the long-term superior returns of value stock *indexes* to justify their *active* stock picking strategies. Recently I came across an article written by a well-known market timer who has twisted long-term index data to disparage stock investing in general in favor of long-term bonds: his current favorite asset class, despite interest rates at historically low levels. Do we detect the smell of desperation in the air?

It's the Media

Getting back to the theme that "investors are their own worst enemies," I've often portrayed the easy *emotional* decision to turn serious investment money over to stock pickers, market timers, and other speculators as a personal responsibility issue. After all, John Bogle, the former chairman of The Vanguard Group; Charles Ellis, the former chairman of Greenwich Associates; and even Ben Graham and Warren Buffett, the gods of active management, have been prominent voices promoting the buy-and-hold virtues of indexed portfolios at different times over the past thirty-five years. And for the past twenty years or so, Dimensional Fund Advisors (DFA) and a legion of independent investment advisors like Equius Partners have been spreading the word through actual practice, publications like *Asset Class*, and numerous books and articles.

But let's be realistic. These experts are the proverbial lone voice crying in the wilderness. Unless you are actively seeking investment *truth* (rather than speculative myth) and just happen to stumble upon it, it's unlikely you'll find it without help. The mainstream media in general and the financial press in particular have a well-entrenched love/hate relationship with traditional Wall Street and active management and aren't about to change their ways anytime soon.

Is That an Iceberg Ahead?

There is a war going on for the hearts and minds of investors. It's between those of us in the minority who rely on a science- and evidence-based approach to long-term investing and trust the wisdom of crowds (the market) versus those who are still mired in an eighty-year-old ideology that relies on various forms of speculation by self-proclaimed intellectual elites determined to prove they're *smarter* than the crowd. Our side is making progress, but it might be too late to save millions of investors who are looking forward to their 401(k) assets and whatever after-tax investments they've been able to accumulate to provide for themselves in retirement. Incremental steps are no longer sufficient.

We have detected recently a slight course change in this ill-fated *Titanic* that involves more than the usual shuffling of the deck chairs. On April 9, *The New York Times* actually published a pro-indexing article. In "Stock Pickers Are No Longer the Stars," the paper even got one of the stars, the CEO of the FPA funds, to admit "the industry stinks." Ah, you can almost smell the fresh breeze of free market realism and the Brut-splashed fragrance of the huddled masses, wafting through the boroughs of Gotham. Could Washington be next? Oh, to dream.

Now, I know what you're thinking: *The New York Times* is constantly bashing Wall Street, corporations in general, profits, "rich people" (that's you, folks), and free markets as if it's the pre-1989 version of *Pravda*, so what's new? Well, what's new is that *The New York Times* is questioning the value of self-proclaimed intellectual elites when it comes to investing. What's next, their questioning of the value of self-proclaimed intellectual elites in government telling us all how to live, what to drive, what to eat, and how take care of ourselves?

Naw, that's not going to happen. The fact is, any article by *The New York Times* that provides real evidence of free market efficiency and superiority over the arrogance and recklessness of the investment industry's intellectual elites will be rare but welcome. And let's be fair. *The New York Times* is a pretty distant third to *The Wall Street Journal* in daily circulation (876,000 versus more than 2 million) and it's not a financial publication.

So in my view it's *The Wall Street Journal* that has a much greater moral dilemma. How can a publication that honors and promotes free market principles; that covers business and investments and all the math, accounting, and statistics that entails; and that is all too happy to point out the general ignorance, arrogance, and bad decisions of the self-proclaimed intellectual elites in government not do the same on a more frequent and critical basis with active managers? We see very little pro-indexing articles in the *Journal*, and when we do they're usually limited to an occasional column that comes off more as an opinion than as fact-based truth.

It's easy to blame advertising for this, because traditional, old-school Wall Street firms are very profitable and know how to promote themselves. But Vanguard and all the mutual fund companies creating and pushing indexed ETFs are huge advertisers as well.

No, the problem is simply that indexing is not complex enough (for the most part), too static in its implementation (if done correctly), too transparent, and overall not nearly as sexy as what hedge fund managers, stockbrokers, and active money managers do every day. In other words, it's boring!

Continued on page 3

I get a good taste for this every time I spend time with friends who still inhabit The Dark Side. I'm thoroughly entertained (and secretly disappointed) by their daily angst or enthusiasm about this or that stock holding, what the Fed's going to do this week, when to sell the 30% gold position in client portfolios, or why one of their colleagues is buying or selling something they're not.[1] These are not stockbrokers, mind you. These are fiduciary money managers. They honest-to-God believe what they're doing with client assets is *investing*, not playing self-centered ego games.

It's Not You

So it's really not fair to blame the typical investor for his or her fundamental investing mistakes. After all, we are a nation of specializers. We know *our* job, *our* profession, *our* own skills and talents, and we rely on others to know *theirs*. We also expect journalists to be watchdogs of government, business, and other areas that affect our lives so that we can make *informed* decisions. Is that happening? In the area of investing, at least, the answer is a resounding NO!

To be fair then, an investor's worst enemy is the financial media. Their second worst enemy is that little voice in their head that says, "Trust him, he's an expert," when it should be saying, "Where the heck does this guy hide his crystal ball?"

If the result of this were that a small minority of rich people confused speculating for investing and fell short by a few million dollars at retirement, it wouldn't be a big deal. But the undeniable fact is that millions of average Americans are working hard to keep their jobs, pay their taxes, feed their families, and strive for a better life while redistributing a very significant percentage of their retirement plan balances to "professionals" who are not delivering on their promises of better-than-market returns and the avoidance of common investment mistakes. We are in the midst of a long-term retirement crisis in this country as a result.

A Solution

So listen up, *Wall Street Journal*. Turn your "Money & Investing" section into "Speculation & Old-School Bets." Feature the hottest hedge fund managers and their most brilliant recent bets. Write articles like "Ten Stocks to Last a Decade."[2] Give us regular, ever-changing lists of the top ten performing mutual funds over the past quarter, year, and three years. Feature talking heads predicting where interest rates, inflation, and tax and Federal Reserve policies are headed. And please, *please* give us a daily column explaining the reason why the market went up or down yesterday. Some of us will read it like a cartoon page and laugh. Others will call their broker and place an order. Speculators are big boys and girls. Let them have their fun.

Then start a new section called "Modern Investing" and feature academic research and real-world strategies behind the growth in indexing and asset class investing. Use survivorship-bias-free databases (not Morningstar) to reveal the truth about the low odds of active fund managers beating *relevant* indexes. Be true to your free-market principles by telling the truth about market efficiency and the role computer technology and the information super highway have had in its development.

Show the perverters of indexing, like those who trade indexed ETFs like hot potatoes, as the charlatans they are and chase them over to the Speculation & Old-School Bets section.

Include a regular subsection featuring the 401(k) investment options of major corporations. But do some *real* investigative journalism. Pull the curtain back on the advisors or consultants selecting the investment options to see what their prior track records of selecting "superior" funds have been. Look very critically at costs. Interview employees to see what they understand or don't about the investments they must choose from. In other words, start shining your light on the cockroaches feeding off the hard work of 401(k) plan participants, *and* on the laziness and imprudence of the corporate decision makers who hire the advisors.

Include another subsection on public pensions, foundations, and endowments. Refer constantly to a copy of The American Law Institute's *Third Restatement of the Law: The Prudent Investor Rule* as you critique the trustees' investment decisions. Who knows? One of your articles might inspire a long-overdue lawsuit that will change this culture for the better once and for all.

In other words, *Wall Street Journal*, grow up and be as responsible and ethical as you wish our politicians were. The less successful newspapers and financial magazines will follow your lead. Now lead.

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[1] This is one of the dirty little secrets of active, discretionary portfolio management: clients of the same firm typically have very different holdings and allocations based on personal preferences, ideas, and bets of each *portfolio manager,* not on unique client objectives, as they might suggest. As you can imagine, performance dispersion among their clients is much greater as a result.

[2] From "The Seven Immutable Laws of Investing," by James Montier

Taking the Scary Out of Stocks

Eric Nelson, Equius Partners

One of the most effective marketing strategies being used by active investment managers to alter the way individuals invest for retirement is to point out that the S&P 500 has been essentially flat for *eleven* years. Compared to bank CDs and long-term Treasury bonds, stocks don't appear to be worth the risk.

Stock pickers are using this information to suggest that this is exactly why you need to hire them to be more *selective* in your stock investing. After all, not *all* stocks were flat or down over that period. Market timers are using the information to claim that they can get you in and out of the market at the right time. And the media is all too happy to play along with this game, rather than do the extra legwork to counter these claims.

We've done some of the extra legwork in previous *Asset Class* articles by pointing out, as always, that there's more to the stock market than the big U.S. growth stocks that dominate the S&P 500. In fact, U.S. and foreign large and small value stock indexes performed much better over this period, as reflected in the global index mix returns below.

Index	Annual Return 2000-2010	Monthly Volatility
One-Month CDs	3.0%	0.2%
Five-Year Treasury Bonds	6.3%	1.4%
Long-Term Treasury Bonds	7.9%	3.3%
S&P 500	0.4%	4.7%
Global Stock Mix	7.7%	5.7%
Global Balanced Mix	8.3%	3.4%

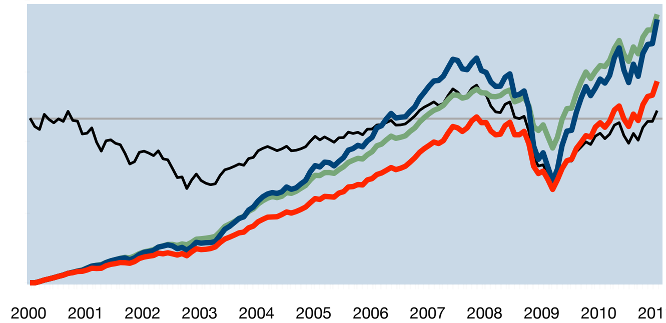
Global Stock Mix = 21% S&P 500 index, 21% DFA US Large Value index, 28% DFA US Small Value index, 18% DFA Int'l Value index, and 12% DFA Int'l Small Value index. **Global Balanced Mix** = 35% Five-Year Treasury Bond index, 13.5% S&P 500 index, 13.5% DFA US Large Value index, 18% DFA US Small Value index, 12% DFA Int'l Value index, and 8% DFA Int'l Small Value index. Mixes are rebalanced to targets annually.

Monthly Volatility is the standard deviation of monthly returns. The returns and performance data are for illustration purposes only and do not represent actual Equius client performance. There are limitations inherent in model allocations. In particular, model performance may not reflect the impact that economic and market factors may have had on the advisor's decision making if the advisor were actually managing the client's money. Mutual fund and portfolio mixes are net of mutual fund fees and expenses but are not net of Equius investment advisory fees. **Past performance is no guarantee of future results.**

Given that most investors build their portfolios over time, we thought it would be helpful to look back on these eleven years from that perspective. After all, because of scary anti-stock headlines and poorly researched articles, many investors altered their stock allocations or quit buying stocks altogether. They shouldn't have.

We ran a simulation from 2000-2010 of a $1,000 monthly contribution into the S&P 500 and the more diversified indexed mixes shown in the table versus a onetime investment in the S&P 500. The following chart shows the results.

Chart: Growth of $132,000



Line	Index	End Value	$ Return
black	S&P 500 ($132,000 up front)	$138,057	$6,057
red	S&P 500 ($1,000/mo.)	$161,392	$29,392
blue	Global Stock Mix ($1,000/mo.)	$210,644	$78,644
green	Global Balanced Mix ($1,000/mo.)	$214,677	$82,677

The time-weighted rate of return, which reflects the actual *investment* return of the index, is the same for both of the S&P 500 simulations. But a steady monthly investment in the index over this period resulted in a higher ending value. This shows the power of dollar-cost averaging over periods with flat to down returns, and the advantage of the "buy low, sell high" effect of a portfolio rebalancing discipline.

Consider this chart also in terms of the emotional value of dropping regular contributions into the portfolio. During the first decline and up to mid-2007, the "accumulators" saw very few dips in total portfolio value. Yes, they, like everyone else, took a big hit during the worst decline in eighty years that followed. But in each case, previous portfolio highs were reached again *and* sooner than the onetime investment in the index.

The moral of this story is that investors should not answer the siren calls of active managers or be intimidated by the fear-mongering media. Invest steadily in a broadly diversified asset class portfolio that reflects your personal risk and return objectives, be patient, and spend your time with family and friends instead of *Mad Money* Cramer and his ilk.