TAM Asset Management, Inc. REVIEW

Diversified, indexed investment strategies for long-term investors, retirement plans, and trust fiduciaries

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Current Trends

The new year started off with a bang for U.S. stocks as the Dow crossed the 6600, 6700, and 6,800 point barriers for the first time. Money is flowing once again at record levels into mutual funds after a slight slowdown in December.

The Nikkei index has continued its fall due to increasing pessimism among Japanese investors. The rise of the dollar to a four-year high against the yen has also hurt U.S. investors in Japanese stocks.

Interest rates have only risen slightly in the U.S., but not enough, evidently, to discourage investors from pouring more money into stocks.

Stock market bulls got a nice boost in confidence when the Green Bay Packers won the Super Bowl. The last time the market dropped the year a National Football Conference team won was 1987...1987?

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Stay Diversified

By Jeff Troutner

U.S. large stocks are on fire and the Vanguard Index 500 fund is the fastest growing mutual fund in the country. IBM goes from dog to darling overnight. My cousin in the construction business called to tell me that a fellow contractor is bullish because P/E ratios "aren't out of line." Uh oh.

Money is pouring into U.S. stocks at an unprecedented rate, but market performance is being driven by only a handful of stocks. We haven't seen this kind of a market since the early 70's. And many of today's investors, myself included, have not experienced the kind of hangover that can result from such a narrow market. The only hangovers I knew in 1973 and 1974 were from too many Strohs, not from the collapse of the "Nifty Fifty."

These can be confusing times for some investors because all the rules are suspect. For example, many are asking themselves why anyone would want to diversify away from the largest, most successful companies in the U.S., especially after they've produced the highest returns of any of the other asset class over the last two years.

Two years ago, few investors were asking themselves that question.

Table 1: Annual Returns

	Prior 2 Yrs. 1993-1994	Last 2 Yrs. 1995-1996
US Large Stocks	5.6%	**30.1%**
US Small Stocks	8.1%	**24.9%**
Int'l Large Stocks	**19.8%**	8.9%
Int'l Small Stocks	**22.5%**	1.4%

Table 2: Yearly returns

	1993	1994	1995	1996
US Large	10.0%	1.3%	**37.4%**	**23.0%**
US Small	17.0%	-0.1%	**30.9%**	**22.3%**
Int'l Large	**32.9%**	**8.0%**	11.6%	6.2%
Int'l Small	**33.5%**	**12.4%**	0.5%	2.3%

The fact is, the performance of U.S. stocks in 1993 and 1994 caused a lot of investors to hold back their investments in those asset classes in 1995. After the S&P 500 shot up 37%, they became even more anxious.

Looking at the numbers—U.S. large stocks up 69% over the past two years—it's hard to imagine that some investors have only *now* decided to move into U.S. stocks or can ignore the near-term and long-term advantages of global diversification.

Fund Performance: Reality vs. Hype

By Jeff Troutner

The financial press makes a big deal about hot performing funds. But how many investors actually realize these extraordinary returns?

Sorting through the Morningstar database we find that the 25 *largest* U.S. (non-index) mutual funds in the country hold almost $400 billion in assets. On average, these funds gained 18.2% last year compared to 22.9% for the Vanguard Index 500 fund. The largest fund, Fidelity Magellan ($56 billion), was up only 11.7% for the year. Other big funds and their returns: Putnam Voyager, 12.8%; Twentieth Century Ultra, 13.9%; and Growth Fund of America, 14.8%. These are all stock funds, mind you, not balanced or global funds.

Some big-name "hedge fund" managers also struggled. George Soros, for example, actually managed to *lose* 1.5% last year on $7 billion of client assets.

That's the reality. Now the hype.

The 25 *best performing* funds in the Morningstar database produced an average return of 48.2% last year. But who reaped those rewards? Investors with a *total* of about $850 million in assets! (And that was at year-end. See the article on page 3.)

Table 3: U.S. stock funds (non-index)

	1996
25 largest funds ($400 billion total assets)	18.2%
S&P 500	**23.0%**
25 best performing funds ($850 million total assets)	48.2%

Since the average fund in this 2175 fund universe had net assets of $498 million, its pretty clear that most investors aren't like your always-in-the-right-place-at-the-right-time brother-in-law.

One more thing. Before you go out and buy those best performing funds look at what happened last year. The top-10 of 1995 underperformed the S&P 500 by a mere 1,760 basis points in 1996 (a good index fund lags by 20). Four actually lost money—only 15 of 2,000 funds managed that feat.

Table 4: Yesterday's News

10 best performing funds in 1995:	66.1%
S&P 500 return in 1995:	37.5%
Their performance in 1996:	**5.4%**
S&P 500 return in 1996:	**23.0%**

I know some of you more analytical types are thinking "but over the two years the best performing funds have a higher return." Sure, but I'm assuming you bought the fund *after* the hot year. Just for the heck of it, I went back one more year. Believe me, it gets worse.

Fund Fundamentals

The information below was obtained from the December 1996 Morningstar database and shows the fundamental data on the DFA "market" index funds (S&P 500, EAFE, and U.S. 6-10) versus their "value" counterparts. P/E = price/earnings, P/B = price/book, P/C = price/cash flow, 5YEG = 5-year earnings growth rate, and Market Cap = median market capitalization ($mil).

U.S. Large

	"Market" Index Fund	"Value" Index Fund
P/E ratio	23.2	16.1
P/B ratio	4.6	1.8
P/C	12.7	7.3
5YEG	16.0%	18.3%
Market Cap	23917	9165

Sample value holdings as of 5/31/96: GM, BankAmerica, CIGNA, MCI

U.S. Small

	"Market" Index Fund	"Value" Index Fund
P/E ratio	23.5	20.5
P/B ratio	3.1	1.9
P/C	14.0	11.4
5YEG	17.7%	11.8%
Market Cap	328	301

Sample value holdings as of 5/31/96: Fremont General, Service Merch., Lennar, Coast Savings

International Large

	"Market" Index Fund	"Value" Index Fund
P/E ratio	29.8	28.7
P/B ratio	3.7	1.8
P/C	12.9	11.0
5YEG	3.0%	1.4%
Market Cap	21153	6943

Sample value holdings as of 5/31/96: Matsushita, Hitachi, Toyota, British Tele., Barclays, Elf Aquitane

Hot Money

By Jeff Troutner

My friends at Dimensional Fund Advisors made me aware of an article in *The New York Times* (December 15) that is further evidence that many mutual fund investors fail to achieve the returns touted by the fund companies.

The article examines the results of several Dreyfus funds. One of them, Dreyfus Aggressive Growth, finished first out of 7,576 funds surveyed by Morningstar for the year ending September 30, 1996, with a total return of 81.92%. The *Times* calculated that during the eleven month period ending August 31 (the fund's fiscal year) Dreyfus Aggressive Growth delivered a total return of 81.70% while investors in the fund experienced a loss of $10.7 million. Impossible? Not at all.

The fund's impressive early performance—up 84.17% in the first six months—generated only modest gains in dollar terms since the asset base was so small—$4.4 million at year-end 1995. The fund's NAV reached a record high on May 24, 1996 (up 122% since inception), and fund assets reached a peak of $168.5 million shortly thereafter on June 12.

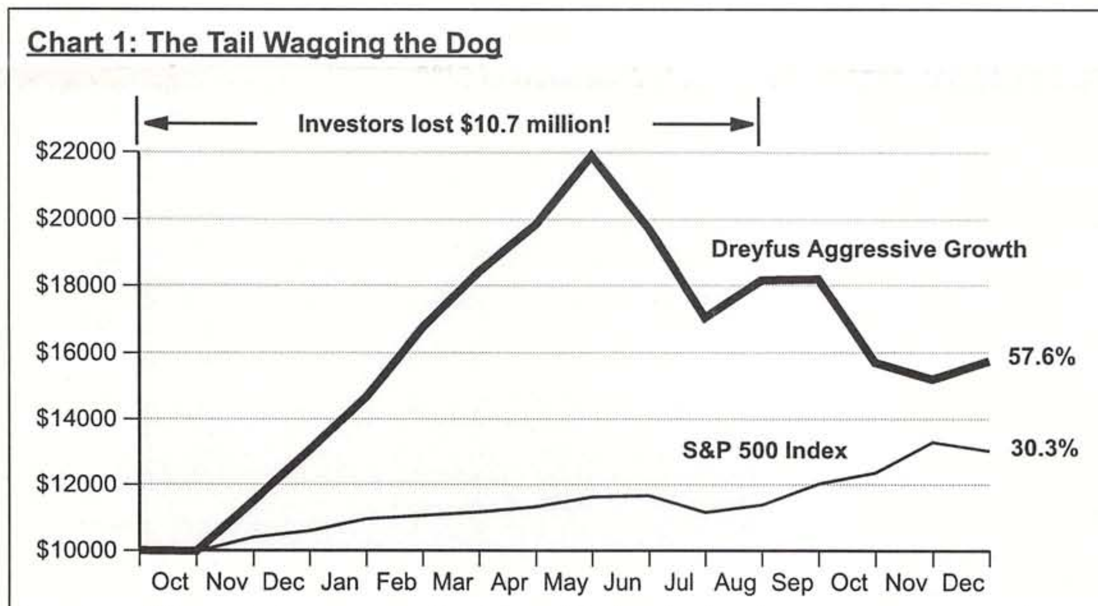
For the six months ending November 30, 1996, the fund *fell* 30.51%, producing investor losses in dollar terms that swamped earlier gains. Thus the paradox of a fund that generated impressive performance vs. the S&P 500 since inception (43.31% vs. 27.64% through November 30, 1996) but whose shareholders have a net loss. As long as investor dollars continue to chase short-term historical performance, disappointments such as these will remain all too common.

An interesting follow-up to that story is that Dreyfus launched an Aggressive *Value* fund at the same time (October 1995). At its peak, the Value fund was only up about a third as much as the Growth fund for the year (23.8% versus 67.6%), but it ended 1996 up 38.9% versus 20.6% for the Growth fund and 23.0% for the S&P 500! Surprisingly (?), it ended 1996 with only $34 million in assets compared to $92 million for the Growth fund.

Table 5: Hot Money

Dreyfus Aggressive Growth Fund

Year-end 1995 Assets:	$4 million
June 12, 1996 Assets:	$168 million
Year-end 1996 Assets:	$92 million



Performance Notes:

Asset Class Returns: 1-Yr. Bonds = DFA One-Year Fixed Income Portfolio; 5-Yr. Bonds = DFA Five-Year Government Portfolio; U.S. Large Value Stocks = DFA Large Cap Value Portfolio; U.S. Small Value Stocks = DFA Small Cap Value Portfolio; Int'l Large Value Stocks = DFA Large Cap International Portfolio; Int'l Small Value Stocks = DFA International Small Cap Value Portfolio;Emerging Market Stocks = DFA Emerging Markets Portfolio.

TAM Portfolio Returns Net of Fees: These are the actual returns of TAM portfolios in each risk category net of actual TAM management fees, custodial fees, and fund expenses. The "Growth" returns were calculated using a model portfolio for the four months1/31/93 to 4/30/93 and actual accounts thereafter. The "Aggressive" returns were calculated using a model portfolio for the three months 1/31/93 to 3/31/93 and actual accounts thereafter. In both cases, the maximum TAM fee was deducted, representative custodial costs were deducted, and all mutual fund returns are net of expenses. The "Moderate" returns were calculated using actual account performance since inception. Past performance is no guarantee of future returns. This is especially the case with model portfolios which are not subject to specific economic or market factors.

Asset Class Returns

Year-to-Date Through 12/31/96

Asset Class	Return
U.S. Small Value Stocks	22.3%
U.S. Large Value Stocks	20.2%
Emerging Market Stocks	11.4%
Int'l Large Value Stocks	7.8%
5-Yr. Bonds	6.6%
1-Yr. Bonds	5.8%
Int'l Small Value Stocks	0.9%

TAM Portfolio Returns

Through 12/31/96

Risk (% stocks)		YTD 1996	1995	1994	1993	Annual Return 1/93-12/96
Aggressive	(100%)	11.6%	15.1%	5.3%	21.1%	13.1%
Growth	(85%)	11.9%	15.9%	2.6%	16.6%	11.6%
Moderate	(65%)	9.6%	14.6%	2.1%	14.0%	10.0%

Notes

TAM accounts originally consisted of a blend of traditional "growth"-biased index funds (e.g. an S&P 500 fund) and gradually moved to all "value" index funds as they were introduced by Dimensional Fund Advisors. Client accounts now consist of a blend of index funds representing US large cap value, US small cap value, international large cap value, international small cap value, and emerging market stocks. Balanced accounts also include one-year and five-year bonds funds.

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