



Index Fund Strategies

# ASSET CLASS

A monthly update of asset class performance, trends, & topics for long-term investors

## Index Returns

	1996	1997	1998	Last 6 yrs.	5/21 1999
<b>Bonds</b>					
Short-term	5.8	6.0	5.7	5.4	+ 1.8
Intermediate	2.4	9.2	10.5	7.7	- 2.6
Long-term	-1.3	14.3	12.0	8.9	- 4.4
Global	10.8	8.3	8.4	8.3	+ 2.6
<b>U.S. stocks</b>					
Large Market	22.9	33.2	28.7	21.4	+ 8.6
Large Value	20.2	28.1	12.0	18.3	+ 16.7
Small Market	18.2	24.6	-5.5	12.4	+ 6.3
Small Value	22.3	30.7	-7.3	16.0	+ 7.3
Real estate	33.8	19.3	-15.4	8.2	+ 9.7
<b>Int'l stocks</b>					
Large Market	6.4	5.5	18.2	12.1	+ 2.2
Large Value	7.8	-3.1	14.9	13.5	+ 3.7
Small Market	2.6	-23.7	8.2	4.2	+ 10.7
Small Value	1.0	-22.7	5.3	3.7	+ 12.7
Emerg. Mkts.	11.4	-18.9	-9.4	5.4	+ 29.6

### Descriptions of Indexes

Short-term bonds	DFA One-Year Fixed Income fund
Intermediate bonds	DFA Intermed. Gov't Bond fund
Long-term bonds	Vanguard Bond Index Long-term
Global bonds	DFA Global Fixed Income fund
U.S. Large Market	Vanguard Index 500 fund
U.S. Large Value	DFA Large Cap Value fund
U.S. Small Market	DFA US 6-10 fund
U.S. Small Value	DFA US 6-10 Value fund
Real Estate	DFA Real Estate Securities fund
Int'l Large Market	DFA Int'l Large Cap fund
Int'l Large Value	DFA Int'l Large Cap 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 6 yrs." returns 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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## Markets Update Friday, May 21, 1999

As the table on the left shows, U.S. large growth stocks continue to trail most of the other equity asset classes year-to-date. U.S. and international large value stocks, international small value stocks, and the emerging markets are all showing stronger returns. U.S. small value is only trailing the S&P 500 by 1.3% and has gained strength over the past few weeks.

This is definitely a healthy change for the markets. If a rotation into these better-priced markets continues, it could prevent a more drastic correction, or even severe crash, in the S&P 500 stocks. At over 30 times earnings and 8 times book value, the S&P 500 is priced for perfection in an increasingly imperfect world—rising interest rates, rising inflation, and a serious threat of an expanded war in the Balkans. This rotation is also important in maintaining healthy investor expectations, which became more and more unrealistic as the one-dimensional market roared ahead.

## Indexing the "New Economy"

Jeff Troutner, TAM Asset Management, Inc.

A lot is being written about the existence of a "New Economy," one based on different rules and with much higher investor expectations. To some, this talk is merely rationalization for the out-of-orbit stock prices of Internet-related companies. To others, there is the serious belief that the U.S. economy has entered a new paradigm where the old rules do not apply and the sky's the limit. *Wired* magazine defines the New Economy as a world in which:

- People work with their brains instead of their hands.
- Communications technology creates global competition - not just for running shoes and laptop computers, but also for bank loans and other services that can't be packed into a crate and shipped.
- Innovation is more important than mass production.
- Investment buys new concepts or the means to create them, rather than new machines.
- Rapid change is a constant.

*It is a world so different its emergence can only be described as a revolution (emphasis mine).*

To me, this doesn't sound a lot different from how someone might have described the potential of the U.S. economy at the turn of this century. If alive today, Thomas Edison, Alexander Graham Bell, Henry Ford, John D. Rockefeller, and J.P. Morgan might be offended at the suggestion that these are all "new" concepts. In any case, I will not attempt to support or debunk the notion of a new economy, nor suggest that either investment riches or peril exist at the end of the rainbow. The only thing I will say is that an awful lot of optimistic projections have been built into the prices of many very young companies, as well as some very old ones like General Electric and IBM. If the new economy develops as some believe it will, these prices might be bargains. Only time will tell. But for those interested in concentrating a portion of their

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long-term portfolio specifically in this direction, there are a couple of indexed investment vehicles to consider.

The NASDAQ 100 Shares (symbol, QQQ) are designed to track the NASDAQ 100 index and trade

like a stock on the American Stock Exchange. The index represents the largest and most active non-financial domestic and international issues listed on the NASDAQ Stock Market based on market capitalization. Information on the NASDAQ 100 Shares can be found on the web at [http://options.nasdaq-amex.com/indexshares/index\\_shares\\_N100.stm](http://options.nasdaq-amex.com/indexshares/index_shares_N100.stm).

*Wired* magazine has created the Wired Index, which they described as “the ‘new blue chips,’ which includes a broad range of companies that are using technology, networks, and information to reshape the world.” Guinness Flight Investment Funds has launched a new mutual fund that tracks the index. Information on the fund can be found on the web at [www.gffunds.com/wiredreport.html](http://www.gffunds.com/wiredreport.html).

The table on the left shows the holdings for each of these indexed investments and their percentages of the total. As you can see, large, multi-national technology companies dominate the NASDAQ 100. Many of these companies are in the S&P 500 at much lower percentages. Some of these firms are in all three indexes (shaded names are common to the NASDAQ 100 and Wired indexes).

Since the Wired Index was developed as a “new economy” version of the Dow Jones Industrial Average, the selection of the companies and industries was not exactly objective. Here’s how the manager describes the selection process:

*The companies were selected based on five characteristics: the intelligent use of technology, globalism, communication, innovation and strategic vision. Like Dow and his successors, the choices involved subjective discretion with informal advice from a mix of academic economists and professional financial analysts. No one owning stock in any of the listed companies was involved in the final decisions.*

The weighting of each security in the index is based on a modified market-capitalization methodology that caps each stock at \$10 billion. In theory then, any stock over \$10 billion in size would have the same weighting in the portfolio.

In the final analysis, I view the NASDAQ 100 Shares as an S&P 500 on steroids, with the Wired Index not far behind. Investors with very diversified portfolios, particularly those dominated by value stocks, might consider a combination of these indexes as a substitute for the S&P 500. Unfortunately, we do not have past performance series on these indexes, and every reason you can come up with to avoid growth stocks (high prices relative to earnings [if they exist], the potential for “regression to the mean,” cost of capital principles, etc.) apply to these stocks in the extreme.

But, if viewed in the same light as foreign emerging markets stocks—high growth potential with huge short-term swings—this play on the emerging “new economy” could pay off for patient investors.

NASDAQ 100 Shares					
	S&P 500		S&P 500		
Microsoft	14.2%	4.3%	Parametric Tech.	0.5% 0.05%	
Intel	7.1%	1.9%	3Com Corp.	0.5% 0.08%	
Cisco Systems	6.8%	1.6%	Converse Tech.	0.5%	
MCI WorldCom	6.0%	1.5%	Smurfit-Stone Cont.	0.5%	
Dell Computer	4.3%	1.0%	PACCAR Inc	0.5% 0.03%	
Sun Microsystems	2.2%	0.5%	Citrix Systems, Inc.	0.5%	
Level 3 Comm.	2.1%		Sanmina Corp.	0.5%	
QUALCOMM	1.8%		Adobe Systems	0.5% 0.03%	
Qwest Comm.	1.7%		Concord EFS	0.5%	
Immune Corp.	1.6%		Genzyme General	0.5%	
Oracle Corp.	1.5%	0.36%	PeopleSoft, Inc.	0.5% 0.03%	
Yahoo!	1.5%		Quantum Corp.	0.4%	
Amazon.com	1.5%		American Pwr. Conv.	0.4%	
Amgen Inc.	1.5%	0.4%	VERITAS Software	0.4%	
Nextel Comm.	1.4%	0.1%	Vitesse Semicondctr	0.4%	
Comcast Corp.	1.3%	0.16%	Synopsys, Inc.	0.4%	
Tellabs, Inc.	1.3%	0.18%	Sigma-Aldrich Corp.	0.3% 0.03%	
At Home Corp.	1.3%		FORE Systems, Inc.	0.3%	
Applied Materials	1.3%		McLeodUSA	0.3%	
CMGI Inc.	1.2%		Electronic Arts Inc.	0.3%	
Ascend Comm.	1.2%	0.17%	Centacor, Inc.	0.3%	
Linear Tech. Corp.	1.2%		Adapteq, Inc.	0.3%	
Maxim Intgrtd Prod.	1.1%		PacifiCare Health Sys	0.3%	
Altera Corp.	1.1%		Molex Incorporated	0.2%	
Novell, Inc.	1.0%	0.08%	Northwest Airlines	0.2%	
Xilinx, Inc.	1.0%		Reuters Group PLC	0.2%	
Chancellor Media	1.0%		Electronics for Imaging	0.2%	
Biogen, Inc.	1.0%		Food Lion, Inc.	0.2%	
Starbucks Corp.	0.9%		Dollar Tree Stores	0.2%	
Costco Companies	0.9%	0.19%	Apollo Group, Inc.	0.2%	
Apple Computer	0.9%	0.05%	Network Associates	0.2%	
Cintas Corp.	0.9%		Microchip Technology	0.2%	
Staples, Inc.	0.9%	0.14%	Ross Stores, Inc.	0.2%	
BMC Software	0.8%	0.08%	McCormick & Co.	0.2%	
LM Ericsson Tel.	0.8%		Stewart Enterprises	0.2%	
ADC Telecomm.	0.8%		Comair Holdings, Inc.	0.2%	
Nordstrom, Inc.	0.8%	0.06%	Atmel Corporation	0.2%	
NTL Inc.	0.8%		Tech Data Corp.	0.2%	
Paychex, Inc.	0.7%	0.07%	Fastenal Co.	0.1%	
Bed Bath & Beyond	0.7%		Autodesk, Inc.	0.1% 0.02%	
Uniphase Corp.	0.7%		Herman Miller, Inc.	0.1%	
Compuware	0.7%	0.08%	Lincare Holdings Inc.	0.1%	
Quintiles Transnat'l	0.7%		Andrew Corp.	0.1%	
Biomet, Inc.	0.6%	0.04%	Cambridge Tech. Ptrs.	0.1%	
PanAmSat Corp.	0.6%		CBRL Group Inc.	0.1%	
Fiserv, Inc.	0.6%		Micron Electronics	0.1%	
Intuit Inc.	0.6%		Rexall Sundown	0.1%	
KLA-Tencor	0.6%	0.04%	Worthington Ind.	0.1% 0.01%	
Chiron Corp.	0.6%		First Health Group	0.1%	
USA Networks	0.5%		Corporate Express	0.0%	
<b>Wired Index</b>					
Charles Schwab	4.7%	0.36%	MCI Worldcom	2.8%	1.5%
America Online	4.3%	1.4%	Cable & Wireless	2.8%	
Qwest Comm.	4.1%		Wal-Mart Stores	2.7%	1.9%
Yahoo! Inc.	3.6%		Dell Computer Corp.	2.7%	1.0%
Sun Microsystems	3.4%	0.5%	Lucent Tech.	2.6%	1.4%
Schlumberger Ltd.	3.3%	0.3%	Walt Disney Co.	2.5%	0.6%
First Data Corp.	3.2%	0.18%	Intel Corp.	2.5%	1.9%
Enron Corp.	3.2%		DaimlerChrysler	2.5%	
Reuters Group	3.1%		Marriott Int'l	2.5%	0.08%
Sony Corp.	3.1%		Monsanto Co.	2.3%	0.27%
EMC Corp.	3.1%		Smithkline Beecham	2.3%	
FDX Corp.	3.1%		Nucor Corp.	1.2%	0.04%
Applied Materials	3.0%		Parametric Tech.	0.9%	0.05%
State Street Corp.	3.0%	0.12%	PeopleSoft, Inc.	0.8%	0.03%
Cisco Systems	3.0%	1.6%	Thermo Electron	0.6%	0.02%
News Corp.	3.0%		Axiom Corp.	0.5%	
Nokia	3.0%		Globalstar Telecomm.	0.4%	
American Int'l	2.9%		Affymetrix	0.2%	
AMR Corp.	2.8%	0.1%	Wind River Systems	0.2%	
Microsoft Corp.	2.8%	4.3%	Incyte Pharm.	0.1%	