

Asset Class Returns

August 31, 2013

	YTD 2013	Past 10 yrs.*	2012	2011	2010
Bonds (%)					
One-Year	0.2	2.3	0.9	0.6	1.2
Five-Year	-1.1	4.0	4.8	4.5	5.3
Intermediate	-4.1	5.3	3.7	9.4	6.9
Long-Term	-10.6	7.4	3.5	29.3	8.9
U.S. stocks (%)					
Large Market	16.1	7.0	15.8	2.1	14.9
Large Value	21.3	8.4	22.1	-3.1	20.2
Small Market	21.4	10.9	18.4	-3.2	30.7
Small Micro	21.8	10.4	18.2	-3.3	31.3
Small Value	21.1	11.3	21.7	-7.6	30.9
Real Estate	-0.7	11.4	17.5	9.0	28.7
International stocks (%)					
Large Market	6.6	8.4	17.8	-12.3	9.3
Large Value	7.9	10.2	16.6	-16.9	10.6
Small Market	10.3	12.8	18.9	-15.4	23.9
Small Value	11.9	13.5	22.3	-17.5	18.1
Emerg. Mkts.	-11.2	17.4	19.2	-17.4	21.8

All returns except "YTD" (Year to Date) are annualized.

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

"Past 10 yrs." returns are ended 12/31/12.

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.

Equius Partners, Inc.
3 Hamilton Landing, Suite 130
Novato, CA 94949
Phone: 415-382-2500
© 2013 Equius Partners, Inc.

September 2013



Other Voices

There Was Nothing "Financial" About the 2008 Crisis

John Tamny, Editor, RealClearMarkets.com

Editor's Note: This article appeared originally on the investment web site RealClearMarkets.com and is republished here by permission. The opinions and perspectives of the author are not necessarily those of Equius Partners.

"Your No. 1 client is the government,' John J. Mack, Morgan Stanley's chairman and chief executive from 2005 to 2009, told current CEO James Gorman in a recent phone call. Mr. Gorman, who was visiting Washington that day, agreed."—*The Wall Street Journal*, September 10, 2013.

The five-year anniversary of the "financial crisis" has predictably generated all manner of commentary about its presumed causes. What's most unfortunate five years later is that "financial" and "crisis" are still used together. It's unfortunate simply because despite what you read, the crisis was decidedly not financial, nor was it caused by a crack-up in the housing market, nor was it caused by the failure of Lehman Brothers.

To understand why, we need only ask if the 2010 bankruptcy of Blockbuster Video had any notable market or economic impact. Obviously, there wasn't much to report. Most sentient beings said then, and would say now, that the bankruptcy of the video rental behemoth spoke to a dynamic capitalist system exhibiting a healthy ability to replace one form of commerce with a better one.

Blockbuster's bankruptcy revealed that when left alone, capitalism works. In Blockbuster's case a low-return, retail-space-eating capital destroyer was replaced by an online DVD service in Netflix; then to show just how dynamic capitalism is, Netflix is now replacing itself with an even leaner Netflix focused on video streaming. Brilliant.

Continued on page 2

Looked at in terms of supposedly “too big to fail” banks, by the time Blockbuster went under it was an irrelevancy. Banks like Lehman, Citi, and Bear Stearns were on the other hand rather large, and for being large, their decline was even healthier for the economy than was the collapse of Blockbuster. Successful economies are always and everywhere about the efficient allocation of capital, so it logically hurts an economy a great deal more when a large business is destroying capital versus a small one.

More to the point, Bear, Lehman, and Citi didn't collapse because they were effectively deploying the capital entrusted to them; rather they imploded precisely because the markets had decided they were not. With the latter in mind, is it remotely credible to suggest that the failure of one or even all three could have caused what is now known as a financial crisis? Figure Citi has been bailed out five times in the last 22 years. In light of the latter number, can anyone credibly explain why bailing out this most errant of banks made us better off, or deterred a “financial” crisis?

Logic tells us that Citi's decline could only accrue to the economy as a massive monument to capital waste being relieved of its ability to destroy any more of said economy. If anything, the best way to foster a financial crisis would be to perpetuate the failed practices of Citi, not to mention Lehman and Bear, by virtue of cushioning their errors with taxpayer funds. As will become apparent, that's what happened.

Considering the housing market that so many financial institutions had so much exposure to, it's to this day said that a moderation of home prices in 2007 led to an economy and market-crushing crisis in 2008. Really?

Explicit in such a viewpoint is that massive lending toward the consumption of a good that doesn't make us more efficient, that won't lead to cancer cures or software discoveries, and that won't open up foreign markets for trade is somehow a source of economic dynamism. In truth, the rush into housing from 2001 until 2007 was a recessionary concept for

limited capital migrating toward consumption over the very saving and investment that authors our economic advancement.

In light of these facts, for so many pundits to say that our “crisis” was born of a housing correction is for them to turn basic economics on its head. Even the most ardent defenders of bank bailouts acknowledge that lending toward housing had grown well out of control by 2007, so with the latter a tautology, how can a correction of these false economies have caused a crisis or economic slowdown? Back to reality: The 2007 housing moderation signaled an economy fixing itself, including putting out of business the financial institutions whose errors had made all the housing consumption possible.

What can't be stressed enough is that an economy robbed of failure is similarly one robbed of success. You can't have one without the other. Failure provides knowledge about how to succeed; it's the healthy process whereby a poorly run entity is starved of the ability to do more economic harm, and in sporting terms, it means that Mike Shula is relieved of his Alabama Crimson Tide coaching duties so that Nick Saban can take over.

Going back to 2008, it was a positive, growth-enhancing capitalist event when Bear Stearns imploded. The financial firm's decline didn't speak to its disappearance by any stretch, but if it had been allowed to go under, management of its myriad assets and entities was simply going to be transferred to someone more skilled. Sadly, the Bush Treasury and the Bernanke Fed blinked. Deluded by the utterly false notion that Bear's failure would lead to a financial meltdown, an economy-weakening deal was worked out whereby J.P. Morgan was induced to acquire Bear in return for the Fed exposing itself to Bear's undesirable balance sheet. And there a healthy corporate implosion was turned into a crisis by an always inept federal government.

Indeed, if Bear is allowed to go under, its assets will still be acquired by better managers, albeit much more cheaply such that the possibility of success for the new

Continued on page 3

managers is greatly enhanced. Put very plainly, within failure are the ingredients of success. Even better, Bear's failure would have signaled to Lehman, Citi, and everyone else that bailouts would not be an option, and that any struggling entity had better find a buyer soon in order to avoid Bear's fate. Investment banks have been failing regularly for as long as they've existed, so this would have been a very orderly process.

Instead, the bailout of Bear, and most notably the bailout of Bear's counterparties, signaled to the marketplace that the Feds were ready and willing to step in to "save" ailing financial institutions, and with that knowledge in hand, they made no provisions for Lehman's actual bankruptcy. About Lehman, let it be stressed again that it was in trouble not because it had made skillful decisions, but precisely because it had deployed the funds entrusted to it in a faulty way. Its implosion in a normal—yes, capitalist—world would have been cause for cheer, but since capitalism's abundant wonders were being trumped by slow-growth government intervention, its collapse created crisis conditions. Federal intervention had distorted the marketplace itself, at which point Lehman's going out of business totally surprised a market that had come to expect a bailout. In short, the wrongheaded bailout of Bear turned Lehman's decline into a crisis.

And then, as if desperate to turn a blaze into a forest fire, the SEC banned the short selling of 900 different financial shares. Think about that. When short sellers enter the market, their entrance tautologically signals the arrival of massive buying power for shorts eventually being covered. But rather than allow the very buyers whose shorts would eventually put a floor under a falling market, the SEC banned them when they were needed most.

After that, it's fair to ask: What was the biggest economic story of the 30 years leading up to 2008? The answer is simple. Free markets had not only won the markets vs. central planning debate, but they won in a big way. It wasn't even close.

But in 2008, a Bush administration that talked a big game about capitalism and markets was running from both at great speed...all to allegedly save capitalism and free markets. Do any readers remember Ronald Reagan's sarcastic quip about the scariest words in the English language being, "We're from the federal government and we're here to help"?

To put it plainly, bailouts are never free. Even if free they would still be disastrous, but as the quote beginning this piece makes plain, the bailouts of financial institutions and car companies in 2008 signaled with great clarity that despite a clear win for free markets in the 30 years leading up to 2008, government intervention in the economy was coming back—with a vengeance.

Given the stupendous poverty and death-inducing failures of central planning in the 20th century, is it any wonder that the markets cracked up in 2008? In 2008 mostly free and capitalistic markets had not only tried to put poorly run financial institutions out of business, but they'd also signaled by doing so that further lending toward housing consumption would cease. Markets had worked somewhat beautifully in ending the crisis that was financial institutions chasing housing and mortgage false economies, but rather than allow markets to work their breathtaking magic, a Bush administration that spoke with a very forked tongue about capitalism renounced it.

"Your No. 1 client is the government" does not speak to a "financial" crisis in 2008, but rather is the natural response of an always forward-looking marketplace to the horrors ahead. Rather than let poorly run institutions fail in concert with less consumption of housing, the markets very correctly convulsed as they wisely priced in a future marked by a perpetuation of faulty banking practices, Fed encouragement of more housing consumption, and the rise of the federal government as the top client of U.S. finance.

Financial crisis? Not by a long shot.



The Broccoli and Pizza Portfolio

Jim Parker, Dimensional Fund Advisors

For some of us, it's hard to give up on the idea that investing should be exciting. Picking stocks can be fun, after all, and there's nothing like getting your timing right and bragging about it later with friends.

For all the accumulated wisdom about asset allocation, risk, diversification, and discipline, some people seem bound to see investing as an end in itself rather than a means to an end. For these folks, picking stocks is a hobby. They follow the gurus and soak up the financial media. Despite evidence to the contrary, they're convinced they can build a consistently winning strategy by exploiting perceived mistakes in market prices.

Part of the reason is the human tendency toward overconfidence. For instance, we all like to think of ourselves as above-average drivers, when that's simply not possible. Likewise in investing, many of us believe we have powers of foresight not evident in the wider population.

A Duke University study of corporate executives published in 2010 found a dismal record of prediction in a group you might think would do well. Indeed, of 11,600 forecasts for the S&P 500 over nine years, the survey found executives' estimates of future returns and actual outcomes were negatively correlated.¹ (This is a technical way of saying the executives were hopeless forecasters.)

Research also suggests the tendency to trade a lot and make confident forecasts about stocks has a gender bias. Whether it's a testosterone-driven instinct among men to boast or something else, study after study shows men find it harder to accept that they are unlikely to "beat" the market.²

For these red-meat eaters, an investment approach that advocates working with the market, diversifying around risks related to an expected return, trading efficiently, exercising discipline, and watching fees and taxes is going

to sound like the financial equivalent of a broccoli and walnut salad: healthy but boring.

Surely the point of investing is to try hard and, Don Quixote-like, to charge at those market windmills? Are we not men?

There are a couple of ways of confronting this mindset. One is to hope for a change in human nature and persuade each would-be master of the universe to separate his urge for ego gratification from his need to build wealth patiently and efficiently.

This is not impossible, of course. But one suspects it would take some time and would require a lot of face saving.

A second approach is to separate the investment nest egg from the play money. If someone really wants to speculate, he can be allowed to do that with the proviso that long-term retirement money be invested the boring way.

This way, the investor can buy some (expensive) entertainment and accumulate a few war stories to share at his next golf game without compromising the asset allocation painstakingly designed for him and his family.

It's understandable that investing is a kind of hobby for some people. After all, this is what keeps much of the financial services industry and media in business.

But in separating the concepts of speculation and investing, you can still enjoy the occasional treat while maintaining a balanced diet.

Call it the broccoli and pizza portfolio.

¹ Ben-David, Itzhak, John R. Graham, and Campbell R. Harvey, "Managerial Miscalibration," Duke University (2010).

² Barber, B.M., and T. Odean, "Boys Will Be Boys: Gender, Overconfidence, and Common Stock Investment," *Quarterly Journal of Economics* 116 (2001).