EQUIUS PARTNERS
*Adding Balance to Wealth*℠

# ASSET CLASS℠

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

## Asset Class Returns

**March 31, 2008 (YTD)**

| | 2005 | 2006 | 2007 | Last 10 yrs. | YTD 2008 |
|---|---|---|---|---|---|
| **Bonds (%)** | | | | | |
| One-year | 2.3 | 4.8 | 5.2 | 4.1 | 0.9 |
| Five-Year | 1.7 | 3.9 | 5.2 | 5.1 | 1.0 |
| Intermediate | 1.6 | 3.6 | 9.5 | 6.4 | 4.3 |
| Long-term | 6.6 | 1.7 | 9.2 | 7.0 | 4.1 |
| **U.S. stocks (%)** | | | | | |
| Large Market | 4.9 | 15.7 | 5.4 | 5.8 | -9.4 |
| Large Value | 10.2 | 20.2 | -2.8 | 8.9 | -7.7 |
| Small Market | 6.1 | 16.6 | -3.1 | 9.0 | -9.6 |
| Small Micro | 5.7 | 16.2 | -5.2 | 10.6 | -10.3 |
| Small Value | 7.8 | 21.5 | -10.8 | 11.5 | -5.9 |
| Real Estate | 13.2 | 35.3 | -18.7 | 10.8 | 2.3 |
| **International stocks (%)** | | | | | |
| Large Market | 13.5 | 24.9 | 12.5 | 8.6 | -8.0 |
| Large Value | 15.3 | 34.1 | 10.2 | 13.0 | -8.2 |
| Small Market | 22.0 | 24.9 | 5.6 | 14.3 | -5.1 |
| Small Value | 23.2 | 28.4 | 3.0 | 16.2 | -3.7 |
| Emerg. Mkts. | 29.9 | 29.2 | 36.0 | 16.0 | -8.8 |

**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 12/31/07.



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**April 2008**

# Keeping It Real(istic)

*Jeff Troutner, Equius Partners*

Political campaigns today seem to focus an inordinate amount of time on what's wrong with our country and very little, if any, on what is right. Maybe it's always been that way. But combined with a housing bust and all the bad investment news surrounding it and the world economy in general, it seems as though we're trying to navigate a perfect storm of pessimism after several years of decent economic growth and exceptional market performance. As I'm sure you'll agree, *this is no fun*.

But is this time really different from so many other periods in our history? In terms of the players and the sources, shapes, scope, and potential solutions to our problems, yes, this time *is* different. What isn't different is that we're in a period of economical and financial turmoil and anxiety. This eventuality—this inevitability—is built into Equius's expectations. It's also built into our diversification. And, most importantly, it's built into our discipline. I'm confident that our experience as investment advisors, combined with the qualities, character, and determination of the American people will see us all through these difficult times to a new period of solid economic and financial growth.

In the meantime, in order to survive these times and thrive during the next cycle it's imperative that we keep in mind a set of basic investment truths. The following list is not all-inclusive, but it covers what we think are the essential realities of investing. Keeping them in mind as we navigate this storm of pessimism should position us for smoother sailing in the not-too-distant future. They are:

- Risk and return are directly related.
- Stock markets fluctuate, sometimes violently.
- "Wall Street" (and the media) thrives on stoking fear and greed emotions.
- Active strategies, especially market timing, rarely pay off over time.
- Structure and discipline are what make asset class strategies work over time.

### Risk & Return

How many times have you heard that there is no free lunch in investing? In order to obtain higher returns an investor must be willing to take higher risk (with one very notable exception below). Yet, there exists a whole industry that in more normal times makes billions of dollars successfully convincing investors otherwise. Auction rate securities, securitized mortgages, bond insurance, massive leverage (borrowing


*"No, no, no, no, no, no, no, —well, just this once."*

to buy securities with little down) and many other even more exotic investment "products" and strategies are sold to investors seeking more than what markets *normally* deliver. This attitude of getting more for nothing fueled a massive housing bubble. In the late 90's it fueled a massive stock market bubble.

We are fortunate at Equius to have aligned ourselves with a firm and a philosophy that constantly reminds us that there is no free lunch in investing—that boiling risk and return to its simplest, most basic form and accepting what results as a long-term *expectation* is the wisest course. We (you and us) not only benefit from the solid fund management of a firm like Dimensional Fund Advisors (DFA), which is not tempted to "enhance" their stock and bond fund returns by trying to suspend or repeal the basic laws of risk and return, we also feel no compulsion to seek these supposed enhancements elsewhere.

The extent and nature of our research into alternatives is, therefore, influenced significantly by our many years experience working in the financial markets and by what we have learned from DFA and the academics with whom they have chosen to align themselves. This association allows us to profit from the one "free lunch" available to investors (diversification among low-correlating asset classes that provides higher returns without a commensurate increase in *portfolio* risk) in a very pure, low-cost, and efficient way, while avoiding the traps laid by Wall Street that attract less disciplined, less experienced, and less knowledgeable investors and advisors.

**Stock Markets Fluctuate**

In contrast to many other advisors, we don't avoid the fact that markets go through bad times. Part of our discussion with prospective clients and our ongoing servicing to existing clients includes a review of historical asset class returns back to at least the severe bear market of 1973-1974, and often includes a discussion of the horrible markets of the early part of the last century. We know these bear markets are unavoidable for anyone who owns stocks *and* believes in the futility and, ultimately, high cost of market timing. Therefore, our emphasis on market reality rather than the false promises of active management strategies tends to create realistic expectations and helps our clients weather these inevitable storms.

**Wall Street Thrives on Emotion**

You've heard me say and write it many times: fear and greed sell. This is such a basic truth and it is so well known that it's truly amazing how the hucksters on Wall Street suck so many investors in with their sales pitches. But they do and they know that in order to continue to do so they must constantly "innovate" and create more and more "product" to sell. Asset class investing, in contrast, is *booooring*. It's simplistic. And it works. Rather than feed emotion, we *fight* emotion. Sometimes, like now, it's extremely difficult. But discipline pays off in an asset class strategy much more than the value-added of lower funds costs, the avoidance of stock picking risks, and the difference in structure among index funds. Discipline is huge, in other words, and it's our defining value from a purely investment perspective.

**Active Strategies Don't Work**

Over-concentration can pay off big. More often it leads to disaster. Just ask the brainiacs at UBS (once considered the safe, conservative investment firm), or Bear Stearns, or Merrill Lynch, or Citigroup, or any number of once reputable banks and investment firms who owned billions of dollars in securitized sub-prime mortgages.

Market timing is arguably worse. Most of the time, investors and advisors practice over-concentration (the result of stock picking) and market timing in combination. After all, why accept broadly diversified market returns when you can predict investment trends so well; when you can predict when oil stocks or real estate stocks will outperform; or when interest rates will turn? Experts are a dime a dozen in this business. Wise and disciplined ones are few and far between.

**Structure and Discipline Work**

If we accept, as we should, that risk and return are directly related, that markets fluctuate, and that Wall Street's focus on emotion and active strategies will lead to disappointing results (at best), it's apparent that the wise course—*the most rational and realistic course*—is to inject a high degree of structure and discipline into the investment process. That's what we have done by developing our asset class strategies and philosophy over the past 15 years and applying these very sound principles in an extremely disciplined way. It's why we have aligned ourselves with DFA and why you will be a successful investor despite (or maybe as a result of) periods of extreme optimism and extreme pessimism.

We have no idea of the length or depth of this current economic malaise. But we know markets, individuals, and companies adjust in ways that have always lead to a continuation of strong economic growth and rising stock prices. Those who are patient, realistic, rational, and disciplined will be around to prosper at the next positive turn.