TAM ASSET MANAGEMENT REVIEW

Modern Investment Principles For Serious Investors

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A Review of 1994

Nineteen ninety four will be remembered by many in the financial industry as the year when massive egos pushed aside common sense and prudence in the once-quiet world of fixed-income securities. If anyone out there still doubts the logic and good sense of passive management of stock and bond portfolios (O.K., most investors, money managers, and stockbrokers *still* don't get it) then last year should erase these doubts.

Let's start with the unfortunate exploits of Mr. Citron, the treasurer of Orange County, California. As if earthquakes, fires, and floods aren't enough to put up with, we had a world class gambler running *billions* of dollars of municipal assets as if they were his personal commodity trading pool. Compounding this, we had the world's largest brokerage firm, Merrill Lynch, advising Mr. Citron and one of the largest newspapers, the LA Times, endorsing him in May of last year for another term in office. Here's what they said: "Robert L. Citron's winning record as Orange County's treasurer-tax collector is good enough that he deserves re-election…How does Citron earn the higher rates [of return]? He takes greater risks. But experts say the risks are not foolish… The cloud drawn over Citron increasingly looks like a bum rap. He deserves another term." A couple of months later it was revealed that Citron had lost over $2 billion entrusted to him.

And where is Merrill Lynch now? In explaining their responsibility, Merrill spokesman Timothy Gilles said "We were a broker-dealer for Orange County, not their financial advisor." Remember that the next time a broker calls you.

So what overwhelming evidence was there to cause Citron and other managers to take such great risks in the bond market last year? Let's look at some very basic interest rate and bond market data leading *into* 1994.

Continued on next page…

Asset Class Returns*
Through December 31, 1994

	1994
United States	
1-Yr. Bonds	+2.5%
5-Yr. Bonds	-3.2%
Large Stocks	+1.2%
Large Value Stocks	-4.5%
Small Stocks	+3.1%
Small Value Stocks	+1.2%
International	
Large Stocks	+8.2%
Japan	
Small Stocks	+29.5%
Continental Europe	
Small Stocks	+11.0%
United Kingdom	
Small Stocks	+4.6%
Pacific Rim	
Small Stocks	-12.1%

The markets recovered somewhat in December, but the doom-and-gloomers are out in force again. This is normal after the kind of year the domestic stock and bond markets had. Few people who are in the business of making forecasts will go out on a limb too far under these circumstances. Don't be surprised if 1995 turns out to be a pretty good year for the financial markets.

*See "Performance Notes" on back page for explanations.

TAM Portfolio Returns Net of Fees*
Through December 31, 1994

Risk (% stocks)	1994	1993	Since Inception 12/92-12/94
Aggressive (97%)	+5.3%	+21.1%	+27.5%
Growth (85%)	+2.6%	+16.6%	+19.5%
Moderate (65%)	+2.1%	+14.0%	+16.4%
Benchmarks Comparisons			
Balanced Fund Index	-2.2%	+11.7%	+9.2%
Capital Apprec. Index	-2.5%	+14.8%	+12.0%
S&P 500 Stock Index	+1.3%	+10.1%	+11.5%
Salomon Broad Bond Index	-2.8%	+9.9%	+6.8%

*See "Performance Notes" on back page for explanations.

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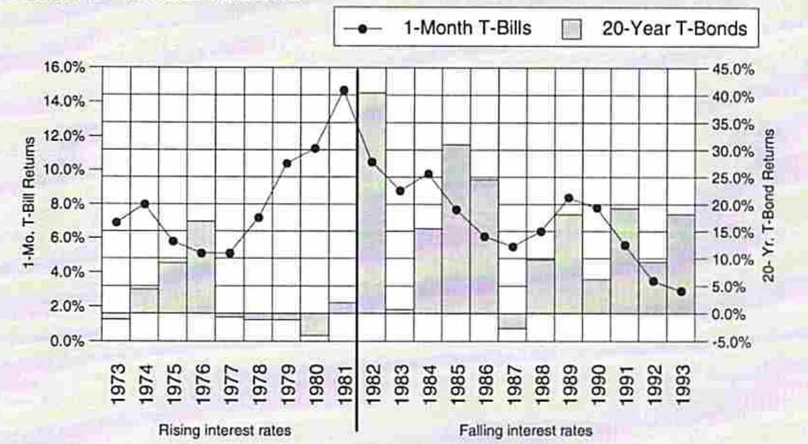
Chart 1: Annual returns



What Citron knew going into 1994...

T-Bill Yield: 1981	14.7%	T-Bill yields plunged
T-Bill Yield: 1993	2.9%	
T-Bonds: Annual return Last 12 years (82-93)	15.3%	Bond returns increased sixfold
T-Bonds: Annual return Previous 9 years (73-81)	2.5%	
T-Bonds: Total return Last 12 years (82-93)	450%	Was Citron a bit greedy?
T-Bonds: Total return Previous 9 years (73-81)	25%	

A Review of 1994 (cont.)

Chart 1 shows the average annual returns since 1973 for 1-Month Treasury Bills and 20-Year Treasury Bonds. If we divide this period into the nine years 1973-1981 when interest rates rose and the twelve most recent years when interest rates fell dramatically, you have to ask yourself, "What were these guys looking at?!"

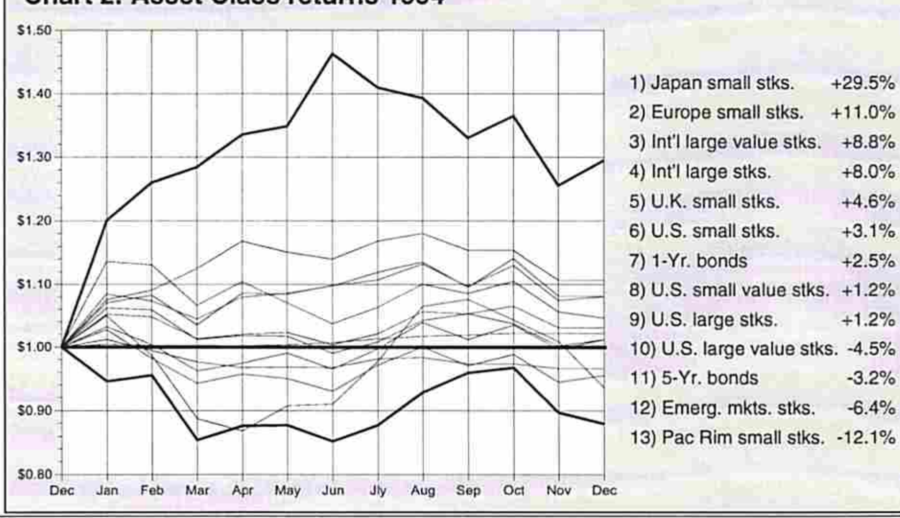
Rates had fallen to their lowest level in 30 years. As a result, risk shifted decidedly toward rising interest rates. Citron continued to bet on falling rates and compounded the risk through leverage (borrowing).

The lesson here is that investors (and taxpayers) must *know* and *understand* the risks they're exposed to. Blind trust, reliance on past performance with no real understanding of how it was achieved, referrals from colleagues with little investigation, etc., will almost certainly lead to disappointment and unnecessary anxiety.

So how did TAM portfolios perform last year? Chart 2 shows the returns for of each of the asset classes we use in client portfolios. Pacific Rim stocks were the worst performers in 1994. The year before they were the best. If you think predicting the direction of interest rates is tough imagine how difficult it would be to forecast relative performance for all of these global markets over the short-term. To give you an idea, the EAFE International Index had a return of 8.0% last year while the average international mutual fund returned -0.7%. International fund managers over- or under-emphasize various markets based on their *forecasted* returns. Last year they guessed wrong.

While the returns for TAM portfolios were modest last year (see the table on page 1), the volatility month-to-month was less than most portfolios and we finished the year in positive territory. Who knows what 1995 will bring? One thing we *do* know is that diversification works over the short and long term and betting on forecasts does not.

Chart 2: Asset Class returns 1994



Performance Notes:

Asset Class Returns—United States: 1-Yr. Bonds = DFA One-Year Fixed Income Portfolio; 5-Yr. Bonds = DFA Five-Year Government Portfolio; Large Stocks = Vanguard 500 Index Fund; Small Stocks = DFA 9-10 Small Company Portfolio; Small Value Stocks = DFA Small Cap Value Portfolio. International: Large Stocks = 57% Vanguard Pacific Index Fund, 43% Vanguard Europe Index Fund (approximates the return of the Morgan Stanley EAFE Index). Japan: Small Stocks = DFA Japanese Small Company Portfolio. Continental Europe: Small Stocks = DFA Continental Small Company Portfolio. United Kingdom: Small Stocks = DFA United Kingdom Small Company Portfolio. Pacific Rim: Small Stocks = DFA Pacific Rim Small Company 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 from 12/31/92 to 4/30/93. The "Aggressive" returns were calculated using a model portfolio from 12/31/92 to 3/31/93. In both cases, the maximum TAM fee was deducted, representative custodial costs were deducted, and all mutual fund returns are net of expenses. 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. **Benchmarks**—Balanced Fund & Capital Appreciation Fund Indexes: Lipper Analytical's indexes representing the 30 largest balanced mutual funds and 30 largest capital appreciation mutual funds in the country.