



Index Fund Strategies

ASSET CLASS

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

Index Returns

	1997	1998	1999	7 yrs.	Last 5/23 2000
Bonds					
Short-term	6.0	5.7	4.6	5.3	+ 1.9
Intermediate	9.2	10.5	-3.6	6.0	+ 2.0
Long-term	14.3	12.0	-7.9	7.4	- 0.3
Global	8.3	8.4	3.7	7.6	+ 2.0

U.S. stocks

Large Market	33.2	28.7	20.8	21.3	- 6.2
Large Value	28.1	12.0	4.8	16.3	+ 0.3
Small Market	22.8	-7.3	29.8	16.5	- 1.6
Small Value	30.7	-7.3	13.1	15.6	- 0.3
Real estate	19.3	-15.4	-2.0	6.7	+ 11.6

Int'l stocks

Large Market	5.5	18.2	28.5	14.3	- 10.7
Large Value	-3.1	14.9	16.3	13.9	- 6.6
Small Market	-23.7	8.2	21.9	6.6	- 4.8
Small Value	-22.7	5.3	19.0	5.8	- 5.3
Emerg. Mkts.	-18.9	-9.4	71.7	13.0	- 18.1

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 9-10 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.

This newsletter is published by
TAM Asset Management, Inc.
321 San Anselmo Ave.
San Anselmo, CA 94960
phone: 415-459-8862
fax: 415-459-1959
email: trout@tamasset.com
Web Site: www.tamasset.com

Editor: Jeffrey C. Troutner

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Markets Update Wednesday, May 24, 2000

Well, it's been a pretty wild ride since the last *Asset Class* was published in April. The chart below shows the performance of the domestic DFA funds since year-end.



The overall market is being hurt by the volatility in the technology sector. Through yesterday (5/23) the NASDAQ Composite index is down 22.2% and the Dow Jones Internet index is off 43.4%. In contrast, the DFA US Large Co. fund (S&P 500) is down just over 6% and the small cap and value funds are flat to slightly down.

The international funds haven't fared as well in this sell-off with the emerging markets in particular giving back some of last year's big gains.

This decline in almost all of the financial markets offers investors still accumulating wealth for their retirement an opportunity to buy in at lower prices. Look at it like stocks are on sale. They may get cheaper yet, but periodic purchases for long-term investors should accelerate, not decline or halt altogether. As Warren Buffett once said, investors pay a high price for a cheery consensus, and that has certainly been the case the last few years. The opposite is also true. Times of uncertainty and fear create excellent buying opportunities.

A Knowledgeable Client Is Good

Jeff Troutner, TAM Asset Management, Inc.

A recent article in *Investment Advisor* magazine¹ categorized today's investors three ways: 1) **Delegators**—those who do not want to assume the responsibility of making their own financial decisions; 2) **Validators**—those who do a lot of their own researching and analyzing, but still like the "stamp of approval" from a professional; and 3) **Soloists**—those who prefer to handle everything on their own.

Personally, I find the most successful investors to be somewhere between Delegators and Validators. They have taken the time to learn some of the basics of investing and have a pretty good idea of their objectives, but they simply don't have the time or the inclination to develop and monitor a long-term portfolio. They are also inundated with so much conflicting information on almost a daily basis that it creates doubts and questions that they feel are better answered by an advisor. Although many Soloists are successful investors, I believe their ranks rotate as emotion and market volatility drive them to become Validators. This

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makes perfect sense to me since I find far too many *advisors* lack the knowledge, discipline, and commitment to stay with a sound strategy through thick and thin.

Delegators

The problem Delegators have is that any investment advisor relationship they enter into is usually based on investment *performance* alone. Without a basic knowledge of financial markets or an advisor's strategy and philosophy they are forced to *trust* that their objectives will be met. This assumes, of course, that they have set realistic objectives in the first place. And how could they if they lacked the basic knowledge of financial markets? A vicious circle? You bet. Most advisor relationships that Delegators enter into are based on a referral from another trusted source like a family member, friend, or other professional advisor like an attorney or accountant. Did those making the referral understand the investment advisor's strategy and philosophy and how well it fits with the investor's objectives and investment temperament? Not likely. The referral was probably based on recent performance (cocktail chatter) or a personal relationship or favor.

As with many Soloists, a wise Delegator eventually becomes a Validator—their knowledge coming from the school of hard knocks or from a good advisor in the form of up-front and ongoing counseling.

Validators

Fee-based advisors (in stark contrast to stockbrokers) like Validators as clients for several reasons. First, most Validators have taken the time to form a basic foundation of knowledge of the financial markets and investment strategies. Many have also taken the time to develop realistic objectives and have a pretty good feel for their personal tolerance for risk. As a result, Validators usually seek out a *compatible* advisor relationship. The client/advisor relationship is then based on *knowledge first*, with trust developing as objectives are met.

Validators are more patient investors since the advisor relationship is usually not based on short-term performance expectations. Validators are also willing students of investment theory and a good advisor will assist a Validator in refining, enhancing, and confirming their investment knowledge.

Knowledge is Good

The *Investment Advisor* article stated that advisors have a higher risk of losing Validators as clients as more information and tools are offered to them primarily through the growth of online services. This could be true, but I think the more likely scenario is that Validators become smarter and, therefore, better clients as time goes on.

The fact is I have found Delegators make lousy clients. They lack the confidence and realistic expectations that a basic knowledge of market history and financial theory can provide, even though the amount of knowledge needed to stay with an indexed strategy long-term is fairly limited and straightforward. The implication by *Investment Advisor* that Delegators make better clients sounds like the old “keep them in the dark, we’re the experts” Wall Street attitude that has been such a disservice to investors for so long.

Investment Advisor magazine worries that too much knowledge leads to a confidence that turns Validators into Soloists. Well, if that's the case, should advisors be proud of their role in that transition or should we simply try to keep “our sheep in the flock”? After all, clients who leave should be the most informed and successful Soloists. (Except for the black hole of Wall Street, advisors don't have the Great Shepherd that accountants have in the form of the U.S. Congress, if you know what I mean.)

So why do Validators use advisors in the first place? From my experience, Validators are usually high net-worth, well-educated, and experienced investors who recognize the destructive power emotion and lack of confidence can have on a long-term strategy. They know the importance of maintaining a consistent allocation through the extreme markets cycles and the huge potential costs associated with shifting allocations in response to these cycles. Very simply, a *good* advisor provides the stability and confidence at a much lower and totally predictable “cost” to the portfolio.

Another reason Validators hire fee-based managers, especially those specializing in indexed strategies, is the stability and consistency these advisors offer in the event of a transition of asset to heirs and other beneficiaries. The nature of the relationship—fact-based, highly diversified, long-term orientation, low cost, etc.—virtually insures that a potentially destructive and costly “repositioning” of the assets won't occur upon the death of the client. The same cannot be said about most broker-based relationships, for example. In other words, there is a “comfort” factor built into a fee-based advisor relationship centered around an indexing strategy.

Of course, second opinions on almost any investment topic, comprehensive performance monitoring, access to better funds and tools, new product evaluations, and availability of full financial planning services are also important to Validators and should not be overlooked. But in the final analysis, *knowledge* and *discipline* are the key ingredients to a successful investment relationship—for both the client and the advisor.

¹ May, 2000 issue.

Online at www.ia-mag.com/ia/May00/cover.html