



Index Fund Strategies

ASSET CLASS

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

Index Returns

	1997	1998	1999	Last 7 yrs.	10/16 2000
Bonds					
Short-term	6.0	5.7	4.6	5.3	+ 5.2
Intermediate	9.2	10.5	-3.6	6.0	+ 7.5
Long-term	14.3	12.0	-7.9	7.4	+ 10.1
Global	8.3	8.4	3.7	7.6	+ 4.9
U.S. stocks					
Large Market	33.2	28.7	20.8	21.3	- 5.8
Large Value	28.1	12.0	4.8	16.3	- 3.9
Small Market	22.8	-7.3	29.8	16.5	+ 4.3
Small Value	30.7	-7.3	13.1	15.6	+ 4.3
Real estate	19.3	-15.4	-2.0	6.7	+ 19.0
Int'l stocks					
Large Market	5.5	18.2	28.5	14.3	- 15.6
Large Value	-3.1	14.9	16.3	13.9	- 7.9
Small Market	-23.7	8.2	21.9	6.6	- 6.6
Small Value	-22.7	5.3	19.0	5.8	- 6.6
Emerg. Mkts.	-18.9	-9.4	71.7	13.0	- 27.8

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.

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Markets Update Wednesday, October 18, 2000

The technology sector of the market is in the midst of a major decline fueled by lower earnings expectations. Especially hard hit are the Internet stocks with many of these off 90% from their highs.

It's interesting that when I talk to people who were totally enamored by the tech stock explosion and rationalized it in the most bizarre ways, the most common response to the collapse in prices goes something like, "Well, these stocks are still way up from their prices several years ago." Well, that's true. But how many investors were actually in the stocks at those prices? It's a sad fact of life in investing that people pile into hot stocks and mutual funds only after they have produced spectacular returns.

It would serve these investors well to read the following article on the common myths of tech stock investing.

The Myths of Tech Stock Indexing

Jeff Troutner, TAM Asset Management

Very few of the mainstream financial publications have been willing to publish negative articles about the tech stock boom—up to now. *The Economist* is one of the few that has been warning of a collapse since late 1998. In their January 28, 1999 edition they write:

Because it is a potent and entirely new medium, the net will change the way the world works and plays. Even so, today's pioneering Internet companies are unlikely ever to earn the vast profits needed to justify their current share prices. Indeed, future historians may well add Internet shares to a long list of industrial assets—including biotechnology firms in the 1990s, radio companies in the 1920s, electric-light companies and railways in the 19th century—that have come spectacularly crashing to earth.

The Economist is known for being a bit too rational in its views and unfortunately it is not read by most investors, but it never hurts to warn of these things early and often. On the other hand, most "bubble.com" stories in the more mainstream *Forbes*, *Fortune*, and *The Wall Street Journal* were either buried deep in their issues, or were offset by numerous pro-tech stories. It should come as no surprise then that a prominent Page 1 story in the *Journal* appeared this past Monday (10-16) titled "Here Are Six Myths That Drove the Boom In Technology Stocks."—after the fact.

In any case, for those who missed the article, here are the six myths:

Myth 1 Tech companies can generate breathtaking gains in earnings, sales and productivity for years to come.

On this myth, the *Journal* points out that one of the most vocal

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cheerleaders for tech recently has been Merrill Lynch's chief economist, Bruce Steinberg, who declared in a March, 2000 report that, "It's Not Tulip Mania." Unfortunately, Mr. Steinberg's declaration came just after the NASDAQ Composite Index had peaked at 5048. Steinberg had noted in his report that tech stocks in the late 80's grew more *slowly* than at most other companies.

Myth 2 Tech companies aren't subject to ordinary economic forces, such as a slower economy or rising interest rates.

As the *Journal* noted, until the late 90's, technology was considered a cyclical business with its sales earnings rising or falling with the economy. But the potential of the Internet seemed to have changed investor expectations in this regard. With many of these new dot-coms crashing and burning, investors appear to have changed their opinion on this one.

Myth 3 Monopolies create unbeatable advantages.

I'm not sure that many investors actually believed that Microsoft could sustain their monopoly in operating systems or even whether it mattered, given the growth in Internet browsers and new computing devices like the "palm" computers. But I do think that many people thought that the sheer size and profitability of Microsoft would cushion it from competition. They were wrong.

Myth 4 Exponential Internet growth has just begun and, if anything, will accelerate.

Founders of web companies believed (and may still believe) this one maybe even more than investors. Most Internet business plans were targeted at "building a brand" first and generating earnings second. That might not be a bad idea in a business that has high barriers to entry, but the Internet doesn't.

Companies like Amazon have built well-known brands, but other sites sell books and CDs just as inexpensively. Priceline built a good brand, but its business model appears now to be seriously flawed.

Many Internet companies felt they could survive on advertising revenues. I can tell you from my own experience that I go to the Yahoo! site probably 25 times a day, yet I have never clicked on an ad or purchased anything from Yahoo! So growth in users is one thing, profits are quite another.

Myth 5 Prospects are more important than immediate earnings.

The thought was that investors would stick around and be patient while these dot-com executives "earned" their way into the *Forbes 400* richest people list through hype and *potential*. Unfortunately, investors need real earnings—in the form of dollars, not hype.

Investors aren't that patient. Proof? Amazon.com is down 75% from its high, E*Trade is down over 80%, Priceline.com is down 97%, and iVillage is down 98%. I could fill the rest of this columns with more names.

Myth 6 This time, things are different.

If I had a dollar for every time I heard this, maybe I would be on the *Forbes 400* list.

Things *are* different this time in terms of the technology and its potential to deliver useful services to consumers. But too many investors get caught up in the emotion and excitement of a "new economy" revolution like this and forget about the effect current stock prices have on future returns.

Very quickly in this cycle stocks became "priced for perfection." In other words, the hype was so great, the revolution so *obvious* that prices skyrocketed before many investors had a chance to even think about it. Then it became, "I don't want to miss out on an opportunity of a lifetime" and investors were buying on speculation without even knowing it.

In the midst of this euphoria last December another Merrill Lynch expert, Henry Blodget, stated that, "It is a mistake to be too conservative in projecting future performance. The real risk is not losing money—it is missing major upside." Ouch! One can only hope Mr. Blodget put his own money where his mouth was.

Unless the tech sector undergoes a stunning reversal, articles like the *Journal's* "Myth" article will be followed by some real investor horror stories. I've personally heard too many already. But this decline in the big tech companies and even some of the larger Internet companies could be a unique opportunity for *patient* investors to participate in a depressed sector that might be underweighted in their portfolios. As always, I think investors should index the sector and avoid cap-weighted portfolios, much like our approach to foreign emerging markets.