ASSET CLASS®

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

Asset Class Returns

	1999	2000	2001	Last 9 yrs.	7/25 2002
Bonds					
Short-term	4.6	6.7	5.8	5.5	2.5
S-T Global	3.7	6.7	5.9	7.3	5.6
Intermediate	-3.6	13.5	8.2	7.1	8.3
Long-term	-7.9	16.6	8.2	8.1	4.3
U.S. stocks					
Large Market	20.8	-9.3	-12.1	13.3	- 26.4
Large Value	4.8	10.2	3.8	14.1	- 3.4
Small Micro	29.8	-3.6	22.8	14.8	- 14.9
Small Market	25.4	2.5	12.7	12.6	- 21.2
Small Value	13.1	9.0	22.7	15.6	- 10.0
Real estate	-2.0	28.4	13.2	9.6	- 2.6
Int'l stocks					
Large Market	28.5	-14.0	-20.8	6.3	- 12.5
Large Value	16.3	-0.2	-15.3	8.6	3.4
Small Market	21.9	-5.4	-10.5	3.1	10.0
Small Value	19.0	-3.1	-4.6	3.6	12.3
Emerg. Mkts.	71.7	-29.2	-6.8	5.1	- 6.0

Descriptions of Indexes

Short-term bonds	DFA One-Year Fixed Income fund
S-T Global bonds	DFA Five-Year Global Fixed
Intermediate bonds	DFA Intermed. Gov't Bond fund
Long-term bonds	Vanguard Long-term Bond Index
U.S. Large Market	DFA US Large Co. (S&P 500)
U.S. Large Value	DFA Large Cap Value fund
U.S. Small Micro	DFA US 9-10 fund
U.S. Small Market	DFA US 6-10 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 9 yrs." returns are ended 12/31/01 and 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 **July 26, 2002**

There is only one word to describe the stock market for the month of July: **Ouch!**

For most of the recent stock market slide, small cap and value stocks have performed relatively well. That all changed in July. What we are witnessing now is more of a 1973-1974 market where the price of virtually every stock falls, rather than a rotation among the asset classes. What is not like 1973-1974 are the low inflation, low interest rates, relatively strong economy, generally strong consumer optimism, and other fundamental positives we enjoy today.

Corporate fraud is a problem, but is there any doubt that stocks would have risen to historically high prices regardless? The threat of new terror attacks has not been eliminated, but, again, it's doubtful that this threat has much to do with the stock market correction. As always, faith in our markets, our economy, and our freedoms will prevail and corporate earnings and dividends will rise again.

Another Benefit of Small Cap & Value Indexing

A Cap on Greed & Irrational Expectations

Jeff Troutner, TAM Asset Management, Inc.

A common criticism of small cap and value index funds is the fact that stocks are sold from these funds after their prices have risen to the point that they become larger or "growthier" than the limits of the funds allow. In other words, profits are "cut short" in these stocks because of the non-emotional, mechanical, and non-human dictates of the indexing methodology.

Like a lot of lessons learned over the last two years, it turns out this ain't so bad after all. Just take a look at the performance of the S&P 500 and Wilshire 5000 Total Market Index since 1998. The handful of very large growth stocks that drove those returns soared and then crashed. As a result, investors in these index funds road the stocks up and road them back down. Before you take this as a criticism of index funds, note that the ride was worse in the actively-managed growth funds (Table 1).

Chart 1

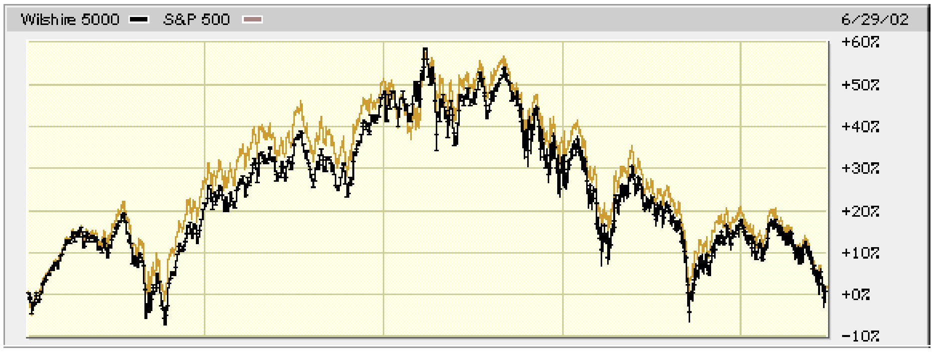

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Table 1: Total Returns

	1995 - 3/00 The "New Era"	4/00 - 6/02 The Fall	1995 - 6/02 The Full Cycle
Large Growth Funds	300.3%	-50.3%	99.4%
Wilshire 5000	243.8%	-32.6%	131.9%
S&P 500	259.0%	-32.0%	144.1%

Source: Morningstar

In the case of an S&P 500 index fund, a stock is sold only after it drops so far in value that it becomes too small for the index, or another stock that is more representative of the current economy needs to be added. In these cases, it's usually laggard "old economy" stocks that get the axe. In "Total Market" index funds, the stocks simply run up and run back down in price. Removal from these funds usually means a total collapse in a stock's price.

Now, contrast this with the small cap and value stock index (or asset class) funds. Companies that are successful—their prices rise sufficiently— get their small cap and value diplomas and head out to the big, bad "growth stock" world of much higher investor expectations. If they fail (the stock price languishes as growth stocks in general rise or the price falls on a relative basis) they go back to school, get gobbled up by a competitor, or file for bankruptcy. If the managements of these companies pull things together again, the market will reward them with an increasing stock price, the small cap and/or value index funds that purchased them will benefit from the rise once again, and they may earn a second chance to excel in the growth stock arena. Some companies, like IBM, have earned multiple degrees from the school of hard-knocks while others, like Microsoft, seem to get it right the first time.

Graduate from small cap or value fund index fund:

Winner!

Booted out of large growth or "market" index fund:

Big Loser!

Another Asset Class Perspective

The period from 1995 to today continues to yield fascinating perspectives on the financial markets and investor behavior and expectations. Here's one more.

The mirror image of large high-priced stocks (growth) are small low-priced stocks (value). As you might expect, as large growth stocks soared from 1995-March 2000, small value stocks were largely ignored by the financial press. In fact, the only time you really heard about the performance of this asset class was in reference to another value fund manager resigning after being inflicted by the stupid bug (after being consider brilliant through so many other cycles). But small value actually did quite well over the period.

Table 2 shows the "New Era" period returns (column 2) and the prior 22-year period (column 1). The large growth and small growth asset classes performed much better than they did the previous 22 years while small value was just a fraction better (17.8% vs. 17.7%). Amazingly, the market correction starting in the spring of 2000 brought annual returns for this recent cycle in line with their prior 22-year average and after another 7 1/2 years, the returns are little changed from the previous 22 years (compare columns 4, 1, and 3).

Table 2: Annual Returns

Asset Class	1 Pre-"New Era" 1973-1994	2 The "New Era" 1995-March 00
Large Growth (S&P500)	10.8%	27.3%
Large Value	14.9%	18.3%
Small Micro	13.6%	21.9%
Small Value	17.7%	17.8%

Table 3: Annual Returns

Asset Class	3 Full Cycle 1973-June 02	4 Recent Cycle 1995-June 02
Large Growth (S&P500)	11.2%	12.4%
Large Value	14.9%	15.0%
Small Micro	13.9%	15.0%
Small Value	17.5%	16.8%

Source: Morningstar; Corresponding DFA fund performance is used as the large value, small micro, and small value asset class proxies in Tables 1 & 2 and Chart 2.

Large and small value returns changed very little over these periods, although quarterly and yearly returns were understandably volatile for all the asset classes. The chart below shows this graphically for the Pre-New Era, New Era, and Recent Cycle periods. The view from the peak of Large Growth Mountain was nice for awhile, but in my opinion it wasn't worth the hike. I'll take the more diversified trail.

Chart 2