Friday, September 5, 1997

**Major Markets**

<table>
<thead>
<tr>
<th>Index</th>
<th>Close 8/31</th>
<th>Point change from 7/31</th>
<th>% change from 7/31</th>
<th>% change from 12/31</th>
</tr>
</thead>
<tbody>
<tr>
<td>DJIA</td>
<td>7622.42</td>
<td>-600.19</td>
<td>-7.3%</td>
<td>+18.2%</td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>899.47</td>
<td>-54.82</td>
<td>-5.7%</td>
<td>+21.4%</td>
</tr>
<tr>
<td>NASDAQ</td>
<td>1587.32</td>
<td>-6.49</td>
<td>-0.4%</td>
<td>+23.0%</td>
</tr>
<tr>
<td>Nikkei 225 (Japan)</td>
<td>18,229.42</td>
<td>-2,102.01</td>
<td>-10.3%</td>
<td>-5.9%</td>
</tr>
</tbody>
</table>

All figures are without dividends reinvested.

Are more normal relationships between the asset classes starting to emerge?

It’s too early to tell, but investors appear to be moving away from the high prices of the large U.S. growth stocks and looking to value stocks and smaller companies for more reasonable valuations.

**U.S. Large Stocks**

The month of August saw a complete reversal in the U.S. large stock averages and, more importantly to TAM clients, a flip-flop in the growth/value relationship. After dominating all year, the S&P has fallen below the DFA U.S. Large Value fund by 2.4%. The DFA fund is also ahead of its average actively-managed counterpart by 5.6% through August.

**U.S. Small Stocks**

There has also been a dramatic shift into small company stocks and the DFA Small Value fund has taken the lead on the domestic side with a 26.8% return through August. The margin between the DFA fund and its actively-managed benchmark is now an incredible 13.4% for the year.

**International Stocks**

In dollar terms every Asian market but Taiwan is down for the year with Indonesia, Malaysia, the Philippines and Singapore all off 30% or more. Japan, by far the largest market in the region, is down just over 7% based on the Dow Jones Global Index.

Much of the decline in these markets is due to currency devaluations and new regulations pertaining to stock trading in certain countries like Malaysia. Although the international large stock funds remain in positive territory for the year, the DFA Small Value fund is down 5.3% and the DFA Emerging Markets fund has gone from a +13.8% at the end of July to -2.7% through August.

**Interest Rates**

Interest rates rose last month with the yield on 30-Year Treasuries rising from 6.32% at the end of July to 6.60%. This was reflected in the price of long-term bonds which fell 3%. The DFA One-Year Fixed Income Fund and DFA Five-Year Government Fund are up 3.8% and 3.9% respectively through August.
The James Grant Paradox

By William J. Bernstein

James Grant cuts a very impressive figure indeed. He is a noted financial journalist, author, publisher of Grant's Interest Rate Observer, and frequent guest on Wall Street Week. His command of financial history is unparalleled, his deductive powers dazzling, and his gift for phrase is Churchillesque. He doesn't have a bad tailor, either. To give you a small taste of how devastating his prose can be, consider his treatment of the efficient market hypothesis in the Introduction of his book, Minding Mr. Market:

To suppose that the value of a common stock is determined by a corporation's earnings discounted by the relevant interest rate and adjusted for the marginal tax rate is to forget that people have burned witches, gone to war on a whim, risen to the defense of Joseph Stalin, and believed Orson Welles when he told them over the radio that the Martians had landed.

Why, then, is Mr. Grant so often wrong? As any viewer of Wall Street Week knows, Mr. Grant has been bearish on stocks and bonds since rocks were hard. In fairness, he has offered some spectacularly profitable advice (for example, shorting the Peso in 1993). However, faithfully following his recommendations over the past few decades would have been very harmful to your wealth. How could somebody so persuasive, clever, and smart be so wrong?

To answer that question, let’s delve into a bit of my wife’s family lore. Her late father was a contented, lifelong worker on the assembly line at Mack Truck. He was a large, handsome, generous man, and a pillar of the neighborhood, but nobody mistook him for a scholar. Early 1942 found him in boot camp. Towards the end of basic training he spent a few days taking aptitude tests. The last section consisted of series of nonsense letter sequences, which the examinees were supposed to decode. My father-in-law’s eyes glazed over. He began to randomly mark answers. A few days later, he was told by an awestruck sergeant that his cryptanalytic skills were too valuable to be wasted in the infantry. He had obtained the highest score on the code test, and would spend the rest of the war breaking the enemy’s ciphers. Alas, my father-in-law was also an honest man. The truth of the matter consigned him to the beaches of Normandy.

The point is this: some problems are so difficult that any effort to solve them is counterproductive. This is the reason why no one can predict the direction of the financial markets with any consistency. The main purpose of market strategists is to make astrologers look good. I never cease to be amazed that most investors think that financial “experts” can forecast stock prices and interest rates from data on unemployment, the Fed Funds rate, and the like. Remember that the best time to buy stocks is usually when economic indicators are the gloomiest. The best time to sell is when there is unlimited blue sky.

So the next time you hear someone predict the direction of stock prices from economic data, ignore them. Even if they’re on Lou Rukeyser every week. Even if their verbal SAT score is 800. Even if they’re wearing a $2000 suit.

We’re Moving Our Offices...

Starting Monday, September 15, our new address will be:
175 North Redwood Dr., Suite 155
San Rafael, CA 94903

Our new phone numbers will be:
TEL 415-499-8862
FAX 415-499-8864

The 800 number remains the same (800-826-4015).