WEALTH MANAGEMENT

CORE Wealth Management

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"HELPING YOU MAKE SMART CHOICES ABOUT YOUR MONEY"

SURPRISE! NO SELLOFF IN 2013

Article by Weston Wellington

The unusually strong performance of US stocks in 2013 was a welcome surprise for investors who are following a simple buy-and-hold strategy and a source of exasperation for many professionals caught flatfooted by the steady rise in share prices.

It was the best year for the S&P 500 Index since 1997, with a total return in excess of 32%. The size and value dimensions were even more rewarding: 2013 was the best calendar year since inception for the DFA U.S. Large Cap Value Portfolio, while the DFA U.S. Micro Cap Portfolio had its second-best performance in 32 years of operation.

To some experts, it wasn't supposed to look like this. A Barron's cover story appearing in November 2012 warned investors to "get ready for the recession of 2013." The title of a Time article on the outlook for financial markets that same month shouted, "Why Stocks Are Dead," in oversize type. A prominent economic forecaster who predicted the downturn in 2008 suggested that four elements—stagnating US economic growth, the European debt crisis, a slump in emerging markets, and military conflict in the Middle East—could combine and lead to a "superstorm."

Another prognosticator—and longtime Forbes columnist—ticked off a long list of worries, including a new wave of housing foreclosures, persistent government deficits, weak consumer spending, high unemployment, and unsustainable corporate profit margins. His prediction for 2013: "the S&P 500 Index drops to 800, a 42% decline." Others fretted about a deepening slump in China that could drag the rest of the world down with it.

Detroit's bankruptcy filing in July—the largest American city to do so—and the acrimonious debate over public finances in many cities and states suggested to some that a tectonic shift in municipal finance was underway with worrisome consequences. One prominent Wall Street researcher observed that "the aftershocks of the largest municipal bankruptcy in US history will be staggering, and Detroit will set important precedents."

Individual and professional investors alike braced themselves throughout the year for a sharp selloff that never materialized. At times, the perverse reaction to rising prices was not delight but apprehension of an even steeper decline to come. On March 5, 2013, for example, the Dow Jones Industrial Average finally eclipsed its previous record of 14164.53, set in October 2007. But the *Financial Times* reported that the prevailing mood among veteran New York Stock Exchange floor traders was "more anxious than joyful."

Month after month, a Greek chorus of financial journalists recycled the same arguments we have heard regularly for the past several years: Economic growth is well below average, stocks are expensive relative to earnings, corporate profit margins are historically high and can only come down, earnings growth is too weak, asset prices have been artificially inflated by an expansive monetary policy, and so on.

With so many economic hobgoblins to frighten them, many investors found it easy to dismiss more positive developments as unsustainable or irrelevant. Auto sales, for example, have been surprisingly strong in recent years, but investors could find plausible reasons for caution in 2013. A New York Times financial reporter observed, "After steady increases for decades, Americans are driving less.

… Walkable cities are growing faster than suburbs. And wherever people happen to move, they are buying smaller, more fuel-efficient cars. … All this means that autos—one of the biggest industries in the United States—will not soon

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WHAT'S INSIDE

Dimensional's Social Core Equity Portfolios

An increasing number of investors are looking for ways to align investment decisions with social values and philosophies. For nearly two decades, Dimensional has applied a transparent, research-based approach to help investors integrate their social preferences into sound investment strategies.

With the recent addition of Dimensional's International Social Core Equity Portfolio, Dimensional now offers a geographically complete suite of socially screened portfolios that, in combination, offer access to the global equity markets.

The US Social Core Equity 2 Portfolio, Emerging Markets Social Core Equity Portfolio, and International Social Core Equity Portfolio each utilize Dimensional's core equity approach, which is structured to provide consistent access to the dimensions of higher expected returns, broad diversification, and efficient, cost-effective execution.

The market

Socially responsible investing (SRI) broadly refers to any investment strategy that considers an investor's financial needs and an investment's impact on society.[1] As public awareness has grown, so have the investment dollars aggregately committed to SRI. In 2012, nearly $1 out of every $9 invested in the US was committed to some type of socially focused investing.[2]

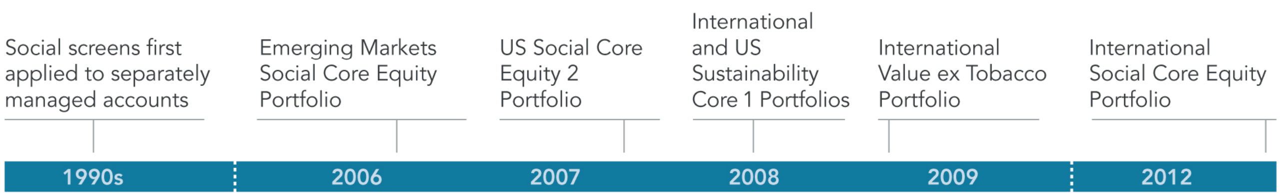
Several trends have driven SRI over the past decade. These include rising institutional and investor demand, legislative mandates for public funds, regulatory developments, the rise in environmentally themed offerings, increased shareholder advocacy, and the growth of community investing.

Dimensional's SRI experience

Dimensional first provided investment strategies incorporating social screens in 1994. Over the years, Dimensional's offering has evolved as clients have expressed interest in SRI strategies. Since 2006, they have created additional socially screened and environmentally focused offerings, including Dimensional's Social Core Equity and Sustainability Core strategies, as well as an International Value ex Tobacco Portfolio.

Dimensional does not regard SRI as a separate asset class but as an alternative framework for investing in conventional asset classes. With this framework in mind, their approach centers on structuring portfolios to capture dimensions of higher expected returns in a cost-efficient, diversified way, while applying a meaningful screening methodology that reflects a broad set of investors' social concerns.

THE EVOLUTION OF DIMENSIONAL'S SRI OFFERINGS



Summary

With a broad suite of socially screened portfolios for regional or global investing, Dimensional has expanded the global opportunity set for investors interested in social investing. These portfolios seamlessly integrate an investor's financial goals and social issue preferences to offer the structural and cost advantages of a core equity approach.

1. Socially responsible investing, which is also known as sustainable and responsible investing, broadly refers to any investment strategy that seeks to consider both financial return and social good. The three main advocacy issues within SRI are social, environmental, and corporate governance.

Ethical investing falls within the social category; sustainability investing falls within the environmental category. According to the Forum for Sustainable and Responsible Investment (formerly the Social Investment Forum Foundation), SRI is implemented mainly through investment analysis and portfolio construction, shareholder advocacy, and community investing.

2. "2012 Report on Sustainable and Responsible Investing Trends in the United States," (Washington, DC: US SIF, 2012).

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regain the explosive growth of the early 2000s."

Some Americans are indeed buying more fuel-efficient cars; electric-only Tesla luxury sedans are popping up in driveways in tony neighborhoods across the country. But many other Americans are eagerly signing contracts for powerful full-size pickup trucks; light-duty truck sales were up roughly 20% through November, and the Ford F-150 continues to be the best-selling vehicle in America by a substantial margin. Last year turned out to be a rewarding one for shareholders of most auto manufacturers and suppliers as well.

What can investors learn from 2013's market behavior?

Most of us accept the idea that predicting the future is difficult. And predicting how other investors will respond to unpredictable events is harder still. But, for some of us, the temptation to engage in such efforts is irresistible. If only we could do so, we could be so much wealthier, have the satisfaction of outwitting other clever market participants, and make ourselves more attractive to members of the opposite sex. But results from this past year tell us we should be skeptical of our ability—or anyone else's—to do this well enough to outperform a simple buy-and-hold strategy. When investors are studying the long-run record of US stock market returns several years from now, we suspect many of them will find it difficult to recall exactly what it was that they were so worried about and discouraged them from pursuing the capital market rewards that were there for the taking.

THE GOLDEN TICKET TRAP

In a popular children's story, the young hero pins all his hopes on finding one of a handful of "golden tickets" hidden among millions of candy bars. It seems many people approach investing the same way.

The notion that the path to long-term wealth lies in locating secret and previously undiscovered treasures in the global marketplace of securities is one regularly featured in media and market commentary.

One magazine, for instance, runs a feature called "Fund Managers' Secret Stocks," referring to supposedly "bargain" stocks the pros keep hidden. (How the stocks can be secret when splashed on magazine stands nationally is not explained.)

Likewise, a popular business broadcaster regularly tells its viewers about the "under-the-radar" stocks that Wall Street analysts don't want them to know about.

This stuff sells because it plays to a misconception about how markets work: that they are like beaches after a hot day, full of buried treasures. All you need, in this view of investing, is a virtual metal detector to find the money that people left behind.

You could get lucky this way, of course. But basing a long-term investment strategy on stumbling across the equivalent of a mislaid trinket in the sand or a golden ticket in a chocolate wrapper is not likely to be sustainable.

It's a haphazard approach, reliant on chance and requiring a lot of work that is unlikely to be rewarded. Worse, it means taking unnecessary risks by tying one's fortunes to a handful of securities or to one or two sectors.

Taking big bets on a single sector or commodity is a bit like buying a chocolate bar in the hope of finding a golden ticket.

There's an element of pot luck, and you're exposing yourself to idiosyncratic risk related to that sector or industry.

On the subject of hidden treasures, gold itself can have a special allure for investors, particularly in uncertain times.

Indeed, the yellow metal has had a couple of spectacular runs, in the 1970s and in the 2000s. But there have been long lean times and significant volatility in between, which makes gold a highly speculative bet.

In early 2013, the *Daily Mail* in the UK carried the headline, "Gold Set to Shine Even More Brightly in 2013."

The rationale was that with investors scouring the world for "safe havens," gold could reach as high as $2,500 an ounce by year end.[1]

As it turned out, gold suffered its biggest annual loss in three decades last year, with its spot price falling 28% in US dollar terms. From an all-time high of $1,920 in September 2011, gold fell to just over $1,200 by the end of 2013.

Now, adopting some exposure to gold may well suit some investors as part of a broadly diversified portfolio, but taking speculative bets on a single commodity, sector, or stock is more akin to blind hope than to anything else.

The popularity of media stories about hidden bargains and undiscovered stocks is understandable. Like townsfolk in a bar overhearing the boasting of gold diggers down from the hills, we desperately want to believe in El Dorado. But this sort of speculation is really no different than gambling. In contrast, sound investment starts with identifying the risks worth taking and minimizing the risks that don't come with an expected reward, like taking a big bet on gold. You can help reduce risk and increase flexibility by diversifying.

It's true that you can get lucky the other way, like the boy in the chocolate factory story. But the chances are against you.

And keep this in mind: The best investment may not be the golden ticket anyway.

1. "Gold Set to Shine Even More Brightly in 2013," *Daily Mail*, January 2, 2013.

OPINIONS

There are almost as many opinions as there are people in the world. Recently, an article in the *Financial Advisor* magazine reported that Jeremy Grantham, the founder of GMO, took "pot shots" at Eugene Fama and his winning of the Nobel Prize in Economics and his Efficient Market Hypothesis. His thoughts were based on the ability of a fellow Fama Nobel laureate Robert Shiller to accurately predict both the tech and housing bubbles.

It is not likely anyone has ever said that it is totally impossible for a person with some degree of luck to predict a certain happening in the market. Sooner or later that lucky someone is able to predict that a certain event will happen, and when that occasion does happen it seemingly becomes newsworthy with much media hype. However, seldom are there reports of all the misses in the predictions that are made by these same people when they are not being quite so lucky.

Our viewpoint and that of Eugene Fama is that it is believed that no one can consistently predict the market and be able to tell you consistently when to get in and out of the market. That is why it is our practice to take a scientific approach to the markets by taking advantage of the fluctuations in the market through the use of "rebalancing—buying low and selling high" rather than trying to predict the tops and bottoms of the market.

FOR EVERYTHING THERE IS A SEASON

This is the time of the year where you are assessing your tax situation and are more than likely completing the funding of your Traditional or Roth IRA's, or other retirement plans for the year 2013. Hopefully, the majority of you are able to make retirement contributions that maximize the limits allowed under the law. There may be some cases where you just cannot afford to utilize the maximum limits. Don't let that stop you from making a retirement plan contribution. Many times when you are younger you don't have a lot of extra money to invest, but it is one of the best times for you to do so. You have time on your side, and even smaller amounts invested now may result in a sizeable nest egg when you reach retirement age. Also, making your contributions early for 2014 to your retirement accounts may be in your plans in an attempt to capitalize on any growth that might occur in 2014.

Even though the groundhog told us that there would still be more winter, many of us are probably planning for what we will be planting in our gardens this year or thinking about what landscaping and plantings we will add to our yards this year. Some of you may be looking through brochures and planning your summer vacation. Spring brings us hope and enthusiasm for new beginnings, for enjoying the weather, and enjoying outings with family and friends.

We wish you and yours a **Happy Easter** and **Happy Spring**!

Our Basic Tenets

Our objective is to design portfolios using passive asset class funds that maximize investors' returns within their tolerance for risk. Here is what sets us apart:

- Fee-only investment management
- A disciplined investment strategy
- Access to institutional no-load passive asset class funds
- An academic Nobel Prize-winning investment approach
- A tax-efficient focus with valuable tax- and estate-planning ideas
- Risk tolerance assessment
- Periodic portfolio rebalancing
- Continued access to academic research
- Periodic portfolio rebalancing
- Regular communications and state-of-the-art reporting
- No front-end loads, no back-end loads, no surrender fees, not locked in
- MOST IMPORTANT … A TRUSTED ADVISOR RELATIONSHIP

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