THE EDUCATED INVESTOR

Spring 2001

FOCUS
Asset Management Company

MISSION: IMPROBABLE

The movie industry thrives on spinning our dreams into reality, where heroes use lightening-fast reflexes to hit all targets and dodge all bullets. If only the investment industry worked similarly! Our hero would be the broker who could outsmart or expertly "time" the market, ensuring clients' funds were fully invested when the market roared forward, while nimbly dodging those periods when the climate turned bearish.

Do such talents exist? Alas, while the market can be entertaining, its lessons can be sobering, as was evidenced in a recent study published by University of Missouri-Columbia Professor John D. Stowe in the *Journal of Investing*.[1] Stowe quantified the odds of succeeding at a market-timing mission — and the consequences of failing.

Stowe analyzed market returns[2] for the period 1991-1998, when we were enjoying a strong market. He looked at what would have happened during 2,023 trading days if a portfolio omitted returns from the best and the worst 10, 20, 30, and 40 days of market performance. He then calculated the compound annual returns of such strategies, providing the figures before and after an estimated expense of 1 percent for a "round trip" buy-and-sell trade, not including taxes. Compare the results above.

If You Missed These BEST Days (Out of 2,023 Total) ...	Pre-Expense Returns	After-Expense Returns
0 best days missed	19.87%	19.87%
10 best days missed	15.06%	13.63%
20 best days missed	11.98%	9.21%
30 best days missed	9.40%	5.35%
40 best days missed	7.15%	1.90%

If You Missed These WORST Days (Out of 2,023 Total) ...	Pre-Expense Returns	After-Expense Returns
0 worst days missed	19.87%	19.87%
10 worst days missed	25.85%	24.28%
20 worst days missed	29.56%	26.35%
30 worst days missed	32.76%	27.85%
40 worst days missed	35.74%	29.09%

In other words, if an investor missed the top two percent of total trading days — the 40 best days in the market — returns dropped from 19.87 percent to 1.9 percent, representing a 90 percent loss of the returns that would have been available by remaining fully invested throughout the period. On the other hand, an investor clever or lucky enough to have missed the *worst* market days during the studied period could have considerably increased returns.

So, if investors could just dodge the bullets, avoiding the worst days, while hitting the target on the market's best days, success would be theirs, right?

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Investor Tester

"The future won't be as good as it was," observed Gretchen Morgenson in her March 18, 2001 *New York Times* Market Watch column. The NASDAQ had just entered the worst bear market in its history. Test yourself on your familiarity with the history of markets and the impact of the current one.

Questions:

1. How many bear markets has the S&P 500 experienced since the end of World War II?

a. 3	c. 20
b. 10	d. 50

2. According to the aforementioned *New York Times* article, if the price of Yahoo grew by 15 percent a year from its March 18 price, how long would it take for it to revisit its peak March 2000 prices?

a. 3 years	c. 20 years
b. 10 years	d. 50 years

3. Approximately how old is the world's first stock exchange?

a. 90 years	c. 230 years
b. 150 years	d. 1,200 years

Answers:

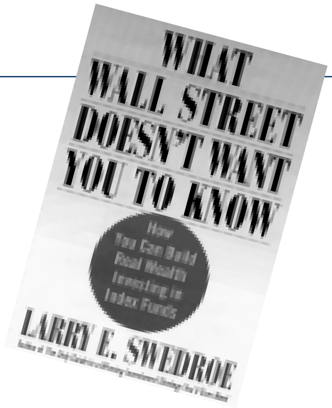
1. A bear market is defined as a stock price decline of greater than 20 percent. Since the end of World War II, there have been (b) Ten S&P 500 bear markets — approximately one every five years. While the bear market that began in March 2001 may or may not exceed the average 15 month duration and 29 percent decline of the previous 10, the point is that current conditions are no anomaly but part of the market's regular cycles.

2. Morgenson's *New York Times* article cites Peter J. Tanous, President of Lynx Investment Advisory Inc., who determined that it would require (c) 20 years for Yahoo to recover to its peak stock price if growing 15 percent per year from its March 18 price. Yahoo represented the most extreme case of the widely held stocks he analyzed, but others also would be slow to recover at a 15 per cent per annum growth rate. For example, Cisco stock holders would have to wait a decade for their investment to recover, Microsoft shareholders would wait six years, and General Electric shareholders would wait three years. The article points out, "This exercise is not meant to advise investors to dump these shares. Rather, Mr. Tanous wants to show how investors will have to temper their expectations and learn to be satisfied with the lower returns that are more typical of the stock market."

3. When the Talmud was written circa 1200 BC - 500 AD, experts were advising "Let every man divide his money into three parts, and invest a third in land, a third in business and a third let him keep in reserve." Thus investing — and trading one's investments — is hardly new. However, the London Stock Exchange was the first official stock exchange, established approximately (c) 230 years ago in 1773. The New York Stock Exchange followed in 1802, Tokyo in 1818 and Sydney in 1872. The NASDAQ is a relatively youthful 30 years old.

Among Good Company

After receiving a strong dose of the inevitable market downturn, investors are perhaps more receptive than ever to the prudent, long-term investment approach espoused by our firm. Among the books that explain passive asset class investing in an easy-to-read format is Larry Swedroe's recently published ***What Wall Street Doesn't Want You To Know***. An April 8 *New York Times* review of Swedroe's book said that our approach "might be exactly what many mutual fund shareholders need."
A separate review in the March 10 *Financial Times* was similarly complimentary, noting that "Swedroe explains the key insights of modern portfolio theory and the capital-asset pricing model without ever once using a Greek letter." We recommend Swedroe's book as an addition to your investment reading library.


WHAT WALL STREET DOESN'T WANT YOU TO KNOW

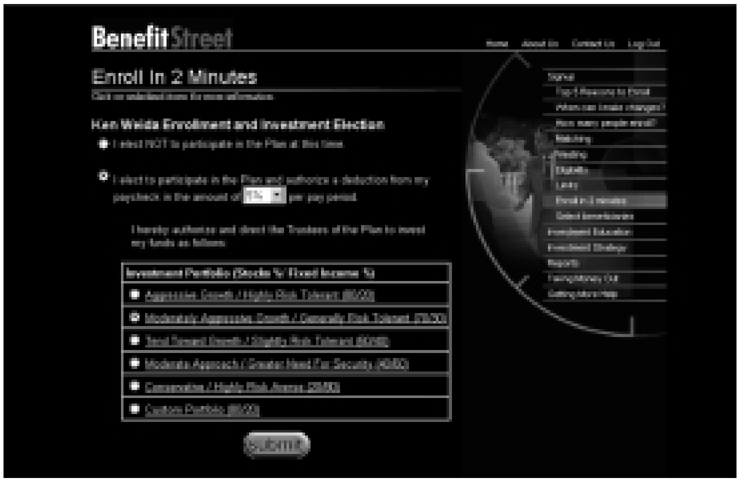
How You Can Build Real Wealth Investing in Index Funds

LARRY E. SWEDROE

Living on BenefitStreet

Educated Investor Special Focus

If you are involved in your firm's retirement plan, you know that today's employees are more financially savvy than ever. They expect the best in benefit plans, easy enrollment, online access to their accounts, quality investment options and excellent service and support.



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Ken Weida Enrollment and Investment Election

● I elect NOT to participate in the Plan at this time.

○ I elect to participate in the Plan and authorize a deduction from my paycheck in the amount of 8% per pay period.

I hereby authorize and direct the Trustees of the Plan to invest my funds as follows:

Investment Portfolio (Stocks % / Fixed Income %)
○ Aggressive Growth / Highly Risk Tolerant (80/20)
○ Moderately Aggressive Growth / Generally Risk Tolerant (70/30)
○ Total Reward Growth / Slightly Risk Tolerant (60/40)
○ Moderate Approach / Greater Need For Security (40/60)
○ Conservative / Highly Risk Averse (20/80)
○ Custom Portfolio (80/20)

Professional guidance from your investment advisor combines with BenefitStreet's secure online benefits program. Together, we can enable cost-effective, high-quality benefit services at your and your employees' fingertips.

Our new alliance with **BenefitStreet** lets your firm offer a fully bundled, Web-based, competitively priced 401(k) service to its employees. Integrating BenefitStreet's program with our full complement of advisory services, we are uniquely positioned to help you implement and maintain a high value, cost-effective and scalable retirement plan for your firm (or smoothly convert from an existing plan).

BenefitStreet is a Web-based record keeper and third-party administrator that specializes in serving 401(k) and other qualified retirement plans across the country. Using the latest technology, BenefitStreet offers the advantages of sophisticated technology in an easy-to-use format. Our alliance with BenefitStreet provides the following advantages:

▲ **Boosts employee recruitment and retention.** BenefitStreet's online benefits packages help attract and retain top employees.

▲ **Reduces your administrative burden.** BenefitStreet's technology lets employees serve themselves, access their plan information, change their beneficiaries and more in a secure, user-friendly Web-based environment. Daily valued reports are available to you and your investment advisor.

▲ **Saves time.** Online enrollment and other procedures dramatically cut administrative workload. Bundled 401(k) plan services and bundled solutions for profit-sharing, money purchase and paired plans enable rapid start-up.

▲ **Scales up fast.** Hiring like crazy? BenefitStreet can add new employees to your program within minutes.

▲ **Keeps costs low.** With online services, you'll reduce the costs and time of paper-based administration.

▲ **Enables implementation of passive asset class management.** Offer employees a sound investment approach based on Modern Portfolio Theory (derived from rigorous, on-going research by leading academic financial economists) and the American Law Institute's 1992 Restatement of the Prudent Investor Rule. Among many other choices, Dimensional Fund Advisors (DFA) mutual funds are available, letting your employees invest in a sophisticated yet prudent manner.

▲ **Helps Employees Invest with Knowledge and Confidence.** Service includes fully developed on-line educational materials, designed to provide Section 404(c) safe-harbors and to help employees invest appropriately for their retirement. Custodial services are provided by Security Trust Company, with client assets in excess of $3 billion.

We are ready to help you establish or convert a benefit plan today. Just follow these easy steps:

1. Let us know that you're interested in more information.

2. We will discuss with you the advantages to using BenefitStreet, and will gather the information needed to offer you a specific description of your new BenefitStreet program.

3. We will provide you with a written report including detailed feature and cost analyses and a plan comparison.

When you're ready, we will use BenefitStreet's proven checklist-based quick-start program to help you activate your new program quickly and efficiently.