

April 6, 2010

Dear friends,

I am fond of the term “value added.” As savvy consumers we expect to receive value added for the price we pay for goods and services we receive and count on in our daily lives. I don’t think I’m going too far out on a limb when I say at one point or another we all have experienced a whole lot of “no value added” in our lives. Does calling tech support for a computer problem or the IRS for a question about your taxes strike a chord with anyone? How about waiting on hold interminably and repeatedly being told how important your call is only to finally be greeted by the dreaded “If you’d like to make a call” disconnect message? The following couple of snippets are taken from a writing by Jim Parker of Dimensional Fund Advisors (DFA). Jim does an exceptional job explaining in plain English some of the real and true value added we enjoy by investing the way we do:

“Experienced negotiators know that the balance of power rests with the party who is prepared to walk away from the table. By contrast, those eager to reach a deal often make the biggest concessions. So it is with investing...”

Whether buying a car, a house, or 500,000 shares of a common stock this is a fundamental economic truism. Without boring you with all the nitty gritty details of bid/ask spreads and efficient market theory jargon let’s use a common sense real world analogy that should resonate. Let’s say you’re interested in buying a new TV but you don’t have to buy it today. You do your homework and determine what an excellent yet still fair price to pay will be for this particular set. You walk into PC Richards or Best Buy and make the offer. The salesperson scoffs and rejects your proposal. You calmly grab your keys and head for the exit. Provided you did your due diligence in coming up with your offer I’ll bet you don’t make it out the door before your price is accepted and the new 52” HD flat screen is soon to be a new member of the family. What happened? At that point in time the salesman simply wanted to make the deal more than you and, voila, you won. No different when it comes to buying or selling blocks of stock. This is what Jim is alluding to in this quote.

How about another one?

“A liquid market is one with lots of buyers and sellers. So naturally, the liquidity premium will be higher in those parts of the market where there are not many participants and where stocks are harder to trade. These are precisely the parts of the market that Dimensional specialises in.”

Looking to always buy at a discount and sell at a premium is what this is all about. So let’s now quantify this value added. Dimensional estimates that for all its buy and sell transactions it delivers 14 basis points or an extra .14% return simply by trading smartly and patiently. Doesn’t seem like much you say? Look at it this way, my fee on all assets managed above \$1 million is 50 basis points or .50% so this single strategy alone offsets approximately 28% of this cost to you. This is essentially a permanent discount and therefore bona fide tangible value added.

Value added is both subjective and objective. As I’ve written about before I always try to add value subjectively by delivering the best service I can to you with each opportunity we interact and by giving you the confidence and courage to know that you are always smartly invested no matter what. Fully explaining all the objective value added that you derive from the engineering behind your portfolios is beyond the scope of this letter but I’m always delighted to discuss this with you further.

Regards and be well,

