July 1, 2006

Dear clients,

You may have heard me say many times that the investment process we are involved in is chock full of some very stark contradictions and inconsistencies. Things like, "The harder we try to beat the market the less likely we are to succeed;" or "The more we pay for an investment the worse it will perform;" or lastly, "Investments constantly outperform investors." Well, here comes one more inconsistency for you. "I am very excited about being able to bring you some truly boring investments."

For the last several years I have been intrigued by the work of an independent investment organization called Dimension Fund Advisors (DFA) www.dimensional.com. DFA's overriding premise and emphatic belief is that financial markets are efficient. This is my view as well. Efficiency doesn't mean that markets and securities are always perfectly priced but rather that they are fairly priced and reflect all available information at any point in time. For those who subscribe to this theory the ramifications are enormous.

A natural, logical, and correct conclusion that can be deduced from the efficient market theory is that the predictive value of stock market and securities forecasters is nil. In other words if an investment advisor, financial consultant, mutual fund marketer, popular financial magazine, stock broker, etc. is ever touting a performance record, or expected performance, of a particular security or mutual fund that has consistently beaten, or is expected to beat "the market" you need to be wary. By no means is this to say that some investments, or records of advisors, don't periodically beat their appropriate benchmarks, but what DFA and I believe is that there is no meaningful statistical evidence to suggest that this "out performance" should be attributed to anything more than pure chance, as opposed to superior skills and/or market prescience.

Let me use an analogy to illustrate my point better. One that I particularly like is the idea of a football stadium full of 50,000 people where it is decided to have a coin flipping contest to determine who the best flippers are. For arguments sake, let's assume heads wins and that after each round all contestants flipping tails must exit the stadium. Not surprisingly, after the first toss approximately 25,000 successful flippers remain. After the second, approximately 12,500 remain. With each succeeding flip the field is reduced by approximately half and accordingly after ten flips it is statistically accurate to expect that approximately 50 "expert flippers" will remain in the stadium. Do you really think these fifty remaining flippers have any better chance of flipping heads the next time than you or me? Of course not and that is just the point DFA is making regarding the value of the advice given by those who are in the business of attempting to manage and/or recommend investments that they would have you believe will consistently beat the market. ***The market is efficient and those who "beat it" over any significant period of time do so merely out of good fortune rather than skill.***

I am keenly aware of the fact that this thinking flies directly in the face of "conventional wisdom" regarding the worth and value of the services that the vast majority of financial advisors purportedly provide. I would guess that for every book or article written about the ramifications of the efficient market theory there are easily a hundred, if not a thousand pieces, that will try to explain how and why one system or another will consistently produce superior investment returns. I feel confident in ultimately letting you as long-term responsible investors decide on the efficacy of this argument. Most of you have heard me say many times that a fundamental objective of mine is to "bore you to success." DFA doesn't put it quite this way but their message is effectively the same in that successful investing necessitates being broadly diversified, cost-conscious, disciplined, emotionally in control, and of course, patient at all times.

What's next? Later this month I will be attending a DFA conference in California after which I will become one of a limited number of approved advisors and be able to add many of their offerings to your portfolios where appropriate. This is a major step forward for us in that DFA funds, unlike Fidelity or Vanguard funds for example, are not available to the general public but only to institutions or through approved advisors. I expect to get out a more detailed mailing to all of you explaining much more sometime before this quarter ends. Until then, be well and enjoy the rest of the summer!