EQUIUS PARTNERS
Adding Balance to Wealth℠

ASSET CLASS℠

An update of performance, trends, research & topics for long-term investors

Asset Class Returns

May 31, 2013

	YTD 2013	Past 10 yrs.*	2012	2011	2010
Bonds (%)					
One-Year	0.1	2.3	0.9	0.6	1.2
Five-Year	0.0	4.0	4.8	4.5	5.3
Intermediate	-1.6	5.3	3.7	9.4	6.9
Long-Term	-4.6	7.4	3.5	29.3	8.9
U.S. stocks (%)					
Large Market	15.3	7.0	15.8	2.1	14.9
Large Value	19.4	8.4	22.1	-3.1	20.2
Small Market	17.3	10.9	18.4	-3.2	30.7
Small Micro	16.9	10.4	18.2	-3.3	31.3
Small Value	18.6	11.3	21.7	-7.6	30.9
Real Estate	8.0	11.4	17.5	9.0	28.7
International stocks (%)					
Large Market	5.7	8.4	17.8	-12.3	9.3
Large Value	5.5	10.2	16.6	-16.9	10.6
Small Market	6.7	12.8	18.9	-15.4	23.9
Small Value	8.8	13.5	22.3	-17.5	18.1
Emerg. Mkts.	-4.3	17.4	19.2	-17.4	21.8

All returns except "YTD" (Year to Date) are annualized.

Descriptions of Indexes

One-Year bonds	DFA One-Year Fixed Income fund
Five-Year bonds	DFA Five-Year Global Fixed
Intermediate bonds	DFA Intermed. Gov't Bond fund
Long-Term bonds	Vanguard Long-term U.S.Treas.
U.S. Large Market	DFA U.S. Large Co. fund
U.S. Large Value	DFA Large Cap Value fund
U.S. Small Market	DFA U.S. Small Cap fund
U.S. Small Micro	DFA U.S. Micro Cap fund
U.S. Small Value	DFA U.S. Small Value fund
Real Estate	DFA Real Estate Securities fund
Int'l Large Market	DFA Large Cap Int'l fund
Int'l Large Value	DFA Int'l Value fund
Int'l Small Market	DFA Int'l Small Company fund
Int'l Small Value	DFA Int'l Small Cap Value fund
Emerging Markets	DFA Emerging Markets fund

"Past 10 yrs." returns are ended 12/31/12.

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Raising the Bar Again

Jeff Troutner, Equius Partners

Longtime clients of Equius know that we have set a high bar for making changes to our core portfolio strategy. In 1995, we moved from a traditional indexing approach with a very pronounced total market dominance to an "asset class" approach built on the science of the Fama/French three-factor research and resulting in a strong global tilt toward small cap and value stocks. We have relied heavily on one firm in particular—Dimensional Fund Advisors—to develop highly diversified asset class funds to implement our new approach.

After eighteen years of real-world results and academic and industry challenges, the Fama/French research has stood the test of time and the Dimensional funds are widely recognized for consistently delivering the return premiums suggested by that seminal research.

In addition, over these eighteen years Equius Partners has steadfastly rejected making changes to our core investment strategy as a result of inferior research, inferior mutual fund choices, or for marketing reasons. While our growing base of long-term clients has benefited from our "stubbornness" (and we've helped along the way with a constant stream of *Asset Class* articles explaining our reasons), there is no question that we have lost the opportunity to serve many more clients because of our refusal to follow short-term industry trends and add more and more "asset classes" to our portfolios. As strategies like the "endowment" approach and inferior small cap and value active strategies like "fundamental indexes" continue to show their weaknesses, we're even more convinced that this is a price we're willing to pay for the benefit of our current clients.

The combination of great academic research, superior implementation of the research at the mutual fund level, effective communication of the principles and benefits of the approach generally and in the context of each client's objectives, and Equius's firm hand on the asset allocation tiller has resulted in a client experience we believe is second to none in the industry. We remain committed to all these things as we raise the bar once again.

New Research

We have decided to take advantage of some exciting new research from Eugene Fama and Ken French and Dimensional's internal research team to increase expected portfolio returns even more than

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our value and small company tilts have delivered so far. I alluded to this "direct profitability" research in the March issue of *Asset Class* ("[A Fourth Factor?]") and published an article last month by David Booth, Dimensional's co-CEO, on the topic ("[The Evolution of Dimensional]").

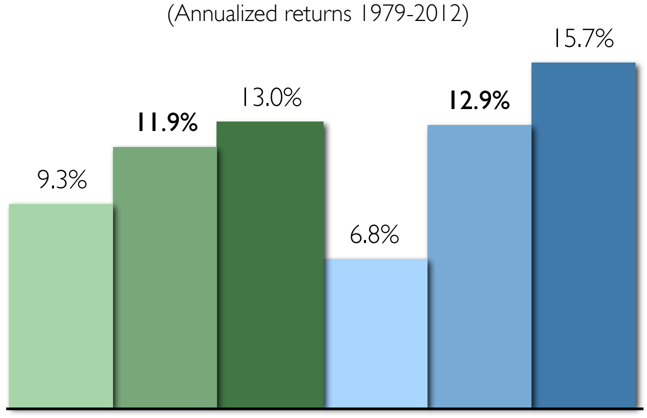
I won't repeat or try to improve on David's explanation here. What I would like to do now is suggest how this research might be applied to improving long-term portfolio returns.

New Funds

We have reviewed research showing the direct profitability screen applied to large and small growth stocks (those with high price-to-book ratios) and to large stocks generally.

Let's look first at growth stocks. In the past we've excluded large and small growth stocks in client portfolios because of their low expected returns. Even though applying a direct profitability screen to these asset classes (Chart 1) improves expected returns pretty significantly, they still lag the expected returns of large and small value stocks by a good margin. Therefore, we don't believe they enhance the risk/return characteristics of *our clients'* portfolios in a meaningful way and so we've decided not to use the four new *growth* funds Dimensional introduced late last year.

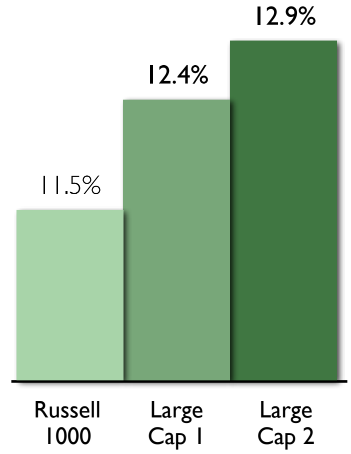
Chart 1: Direct Profitability Applied to Growth
(Annualized returns 1979-2012)



On the other hand, applying the direct profitability screen to a large stock index like the Russell 1000 offers an opportunity to increase expected returns in client portfolios that include an S&P 500 or other large cap index fund (such as the Schwab 1000 fund) while also increasing diversification.

Chart 2 shows two indexes created with a similar set of stocks as the Russell 1000 large company index but with the direct profitability screen applied in increasing measure. Some securities are overweighted compared to the Russell index and some are underweighted as a result of the screen. The new indexes also have a slight small cap and value tilt due to the difference in securities weights from the Russell index. Risk (volatility of returns and downside) is very similar to that of the Russell index.

Chart 2: Direct Profitability Applied to Large Cap
(Annualized returns 1979-2012)



From all indications we've received so far, applying the direct profitability dimension to the large cap asset class can improve the expected return and diversification of our portfolios. When Dimensional launches a new fund with the direct profitability screen applied to large cap stocks, we will review all client portfolios to determine whether a fund change is appropriate.

Notes: Dimensional recently renamed their proprietary indexes to reflect the inclusion of the direct profitability dimension. They didn't ask us first, so naturally the outcome is unnecessarily confusing. Their US Large and Small Growth indexes now represent growth stocks with the direct profitability screen applied. The old growth stock indexes are now named the Dimensional US Large Cap High Price-to-Book and Dimensional US Small Cap High Price-to-Book indexes. Ugh. For Chart 1, we refer to the old indexes as "Large growth" and "Small growth" and the direct profitability indexes as "Large growth+" and "Small growth+." "Large value" and "Small value" remain the Dimensional US Large Cap Value and Dimensional US Small Cap Value indexes.

The Large Cap 1 and Large Cap 2 indexes shown in Chart 2 were created in January 2013 from data provided by CRSP and Compustat. The indexes are rebalanced annually, and back-tested performance results assume reinvestment of dividends and capital gains. Filters were applied to data retroactively and with the benefit of hindsight. Returns are not representative of actual portfolios and do not reflect costs and fees associated with an actual investment. Actual returns may be lower. It is not possible to invest directly in an index, which is unmanaged.

Past performance is no guarantee of future success. There is no guarantee strategies will be successful.