EQUIUS PARTNERS
Adding Balance to Wealth℠

ASSETCLASS℠

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

May 2015

Asset Class Returns

April 30, 2015

	YTD 2015	2014	2013	2012	Past 10 yrs.*
Bonds (%)					
One-Year	0.3	0.3	0.3	0.9	2.1
Five-Year	1.4	2.9	-0.4	4.8	3.6
Intermediate	2.0	5.2	-3.5	3.7	4.8
Long-Term	2.4	23.9	-11.4	3.3	7.5
U.S. stocks (%)					
Large Market	1.0	13.5	32.3	15.8	7.7
Large Value	-0.2	10.1	40.3	22.1	8.1
Small Market	4.0	4.4	42.2	18.4	8.8
Small Micro	3.1	2.9	45.1	18.2	7.8
Small Value	2.4	3.5	42.4	21.7	7.9
Real Estate	4.8	31.1	1.4	17.5	8.1
International stocks (%)					
Large Market	4.2	-5.2	20.7	17.8	4.6
Large Value	4.1	-7.0	23.1	16.6	4.6
Small Market	3.9	-6.3	27.4	18.9	6.7
Small Value	4.7	-5.0	32.4	22.3	7.1
Emerg. Mkts.	1.5	-1.7	-3.1	19.2	8.6

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	Long-term Gov't Bond Index
U.S. Large Market	DFA US Large Company fund
U.S. Large Value	DFA US Large Cap Value fund
U.S. Small Market	DFA US Small Cap fund
U.S. Small Micro	DFA US Micro Cap fund
U.S. Small Value	DFA US 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 12/31/14.

Equius Partners is an investment advisor registered with the Securities and Exchange Commission. Consider the investment objectives, risks, and charges and expenses of any mutual fund and read the prospectus carefully before investing. Indexes are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio. **Past performance is not a guarantee of future results.**

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Let's Save the 401(k)

Jeff Troutner, Equius Partners

We're hearing a lot about a retirement crisis in America. It's real.

- Among all those who died at age 85 or above, 21% had no non-house assets left.[1]
- Of households that lost a member between ages 50 and 64, 60% had non-house assets of $10,000 or less.[2]
- Only 12% of retirement plan sponsors feel that most employees will be financially prepared for retirement.[3]

I could list many more facts, including the trillions of dollars of unfunded liabilities in public pension plans and the sad realities of the Social Security "trust fund," but dwelling on the negative is not the point of this article. Small business owners like us have the ability and the tools to make a very positive effect on the retirement outcomes of *our* employees. But ability and tools are not enough. We need to actually care and develop new knowledge that allows us to move away from the herd, think differently, and take decisive action.

The primary tool we have at our disposal is the defined-contribution 401(k) plan. This is the dominant retirement plan vehicle today and should remain so in the future for many good reasons that I won't go into in this article. For those interested in wading into the defined-contribution/defined-benefit (pension) debate, I suggest visiting the web sites of the Investment Company Institute (ici.org) and the Employee Benefit Research Institute (ebri.org) for starters.

When it comes to maximizing the benefits of a 401(k) plan, it truly does take a village. Those are hard words for a self-reliant, staunch believer in personal responsibility to say, but I say them because I've been in the investment industry for over 30 years. Even the smartest people make really dumb investment decisions. It's the nature of the beast.

So if *you* (employer) truly care about your employees, we (investment advisors) truly care about our clients, and *you* (employee) truly care about your own retirement finances, there are things we all need to do to make it happen. Here's my list.

Treat everyone as if they'll remain a long-term employee.

Everyone we hire full-time at Equius is expected to be a long-term employee. That's not always the case, of course, but it's our mindset.

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Employee turnover is expensive and disruptive. And in small companies like ours, employees are either literally family or are considered family. So competitive salaries, generous benefits, a good working environment, and a healthy work/life balance are all part of our culture.

With long-term employees, it seems only natural then that we should look beyond current benefits to see what retirement might look like for people whose day-to-day efforts contribute to our success. We live in a very desirable but also very expensive part of the country. If our employees want to retire here, it's imperative that we collectively take a serious interest in how they save and invest for retirement and help them optimize results. If they choose to move elsewhere for retirement, the extra money from these efforts should help enrich their lives even more through travel, family, charity, or other interests.

From an employee point of view, long-term employment with one company might not make sense, for lots of reasons. Having a 401(k) plan balance is actually a good thing in this case. Since you own the bulk of your 401(k) assets (some of what your employer may have contributed could be subject to vesting rules), you can take your retirement assets with you to invest in a new company's plan or roll them over into a personal IRA. If the plan you're leaving is as good as the one I will propose shortly, it's very likely that the rollover option is best since most 401(k) plan investment options are a shameful disaster.

Promote good design, early participation, and maximum contribution.

We encourage all of our eligible employees to not only participate in the plan but also maximize what they contribute, if possible. It's not always possible, since current financial needs—such as saving for a down payment on a house, caring for elderly parents, paying private school tuition, and so on—might be assigned higher priority.

If an employee can't contribute the maximum allowed, he or she should at least contribute something on a regular basis. The powerful lessons of compounding, the smoothing of returns that result from consistent investing over all market cycles, the benefits of diversification and tax deferral, and simply the satisfaction that comes from watching the rewards of hard work produce even greater rewards through capital investment cannot be overemphasized. And if the investment options are chosen wisely by the employer and sound investment advice is offered to plan participants, the 401(k) plan will serve as an excellent model for a lifetime of saving and investing outside of the retirement plan.

Auto-enrollment of new employees and a default option, such as a balanced portfolio, are good features. Some plans also include auto-escalation of contributions from a low starting percentage of income. Employees who for personal reasons might find these features inappropriate can simply opt out of them.

Employer matching contributions can also be a great benefit to both the employer and employee. In order to qualify as a "safe harbor" plan, Equius contributes an additional 3% of our employees' income to their plan balances every year. In order to maximize the contributions Phil and I (the old-timers) can make to the plan, we also include a profit-sharing contribution every year. We would have decided to make these kinds of contributions in any case, but it's nice that the law is written to encourage it.

The employees' contributions, the 3% of income Equius contributes, and the investment earnings on these assets are 100% owned by our employees immediately. The profit-sharing assets are fully vested after six years with the firm.

Offer the best investments and advice.

I believe it's wrong to suggest to employees (especially young ones) that they take money that might otherwise be used to enrich their everyday lives and invest in the typical 401(k) plan. This isn't an indictment of the *potential* of such plans, but rather how poorly so many are designed and managed.

Most of these Rube Goldberg contraptions are sold to companies by representatives of massive mutual fund complexes or stockbrokers working for large national firms. The result is typically a plan that is too costly, too complex, and too confusing while offering little to nothing in the way of serious investment options and guidance.

Faced with a dizzying list of barely decipherable investment choices—presented as if recent performance is the only metric on which to judge their value—plan participants play the wealth accumulation equivalent of Russian roulette.

America actually teaches an extreme version of this silliness to our impressionable youth just before they're offered their first 401(k) plan. Jason Zweig describes this madness in a recent *Wall Street Journal* article titled "Stock Market 101: Teaching the Wrong Lessons?" (although why he places a question mark at the end is beyond me).

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Sadly, in the rare event that a local fee-based (rather than commission-based) financial advisor "makes the sale," the result is almost always the same. After all, these advisors must compete with much bigger firms with much bigger reputations and much more polished and expensive brochures. Regression to the lowest common denominator tends to be the path of least resistance.

If one were to take a more thoughtful path that is more likely to lead to better retirement outcomes for employees, what would it be? Based on a wealth of industry and academic research (which I can't reference adequately here, but is readily available to anyone seeking it), here are some suggestions.

Avoid actively managed funds like the plague.

Unless you wish to deduct as much as 2% from your employees' potential annual return, entice them to engage in costly performance chasing every year, and significantly widen the variance between what they receive in investment return in any given year and what the financial markets provide reliably via an index fund, simply don't offer actively managed funds!

Is offering your employees a 1 in 5 chance of outperforming an index fund really a responsible thing to do? Is living in a 1950s-era investment world that Wall Street continually fights to preserve really a responsible thing to do? Is confusing speculation with investing really the message you wish to convey to your employees? If not, stop doing all of it. Dare to be different. Challenge the sellers of your current plan investments with enlightened knowledge, rather than continuing to reward their entrenched ignorance by maintaining the status quo. Or simply fire them and hire Equius Partners.

Limit investment options.

Begin to rebuild your investment offering to participants by limiting investment options to no more than three main categories:

- **Individual index or asset class funds**
- **Risk-based portfolios**
- **Target-date portfolios**

Funds should represent asset classes that capture the risk dimensions that drive expected returns. Index funds can be used for this, but an advisor like Equius provides access to better-structured versions of index funds we call "structured asset class" funds (such as those managed by Dimensional Fund Advisors). Funds that cover short-term, high-quality bonds; U.S. and foreign large growth (market) stocks; U.S. and foreign large and small value stocks; and emerging markets stocks should be sufficient.

Long-term maturity or junk bond funds; sector funds for, say, real estate, oil and gas, or technology stocks; and funds "investing" in commodities, precious metals, or hedge funds should be avoided as they simply add to participant confusion, lead to wealth-destroying market-timing behavior, and reduce long-term portfolio returns with little diversification benefit.

A selection of core individual funds works well for plan participants who understand the principles of risk and return, diversification, rebalancing, and patience. However, even index funds and structured asset class funds can and will be used in destructive ways. Investment advisors like Equius can help alter participant behavior in positive ways through frequent, focused, and sound guidance. Ultimately, however, participants are responsible for their own decisions.

In our view, risk-based portfolios are a better solution than target-date portfolios for participants who would rather not choose their own mix of funds. These portfolios have static allocations among the asset classes, with low-risk portfolios invested more in bonds than in stocks and vice versa. A traditional balanced fund or portfolio (usually 60% stocks, 40% bonds) is risk-based and is often used as the default investment option for plan participants who don't otherwise choose one.

Target-date portfolios change asset allocation over time from higher risk to lower risk. These are simplistic auto-solutions that require only that the participant choose a projected retirement year. As such, they are a one-size-fits-all compromise that often includes many of the investments noted above that we would avoid. For most of these funds, long-term investment returns are also compromised by incorporating active management.

Those considering (or currently offering) online "robo" advice for their participants should think again. According to Vanguard, only 7% of participants offered the service actually use it.

At the end of the day, what we're proposing is a more thoughtful, collaborative, and caring approach to 401(k) investing that all parties to the deal—employers, employees, and investment advisors—should agree will result in better retirement outcomes. Is this too much to ask?

[1, 2] "A Look at the End-of-Life Financial Situation in America," Employee Benefit Research Institute.

[3] "How America Saves," The Vanguard Group.

The Equius 401(k) Plan

Below are the investment options for the Equius Partners 401(k) plan.

Individual Equius clients should find these selections familiar. With the exception of US Large Cap Equity, which was added in July 2013 as a substitute for funds that tracked the S&P 500 Index, these are the core mutual funds we have used to build client portfolios since 1995.

Equius employees create their own risk-based portfolios from these asset class options based on their personal goals and risk tolerance. For those not directly involved in client relationship management, we offer guidance and advice.

Equius offers custom solutions for our 401(k) plan clients that may include additional and/or alternate funds based on their specific needs and objectives.

We present our plan options for illustrative and comparative purposes only. Past performance is not a guarantee of futures returns.

Investment Option	Risk Dimension	# of Stocks	Expense Ratio	Price-to-Book Ratio	Annual Return 1995-4/2015
DFA Five-Year Global Fixed Income (DFGBX)	Short-term, high-quality bonds	-	0.27%	-	5.5%
DFA US Large Cap Equity (DUSQX)	US stock market	956	0.20%	2.49	-
DFA US Large Cap Value (DFLVX)	US large value stocks only	279	0.27%	1.50	11.2%
DFA US Small Cap Value (DFSVX)	US small cap value stocks only	1,194	0.53%	1.23	12.7%
S&P 500 Index	***US stock market***	***500***			***9.8%***
DFA Int'l Value (DFIVX)	International large value stocks only	544	0.43%	1.13	7.1%
DFA Int'l Small Cap Value (DISVX)	International small cap value stocks only	2,178	0.68%	1.01	8.0%
MSCI EAFE Index	***International stock market***	***909***			***5.8%***

A Footnote on Fiduciary Responsibility:

Since we started offering fully "passive" investment strategies to 401(k) plans in 1993, I've carried an American Law Institute textbook to initial meetings. It's so dog-eared, highlighted, and bookmarked that occasionally a skeptical prospective client will refer to it as "a prop."

The textbook is *The Restatement (Third) of Trusts*. I've referenced it several times in previous *Asset Class* articles and wrote a white paper years ago (available on our web site) outlining our investment guidelines within the context of this comprehensive and timely update to *The Prudent Investor Rule*.

On May 18th, in a 9-0 decision, the U.S. Supreme Court ruled that employees of Edison International could sue their employer for breach of fiduciary duties relating to their 401(k) plan investments. The Court specifically referenced *The Restatement (Third) of Trusts* in reaching its decision.

I've said for decades now (sadly) that it will take a number of major court decisions to change the established 401(k) culture in this country. Needless to say, I continue to carry my "prop" to initial meetings with 401(k) decision-makers hoping I'll be asked one day to turn to those marked-up pages!