Planning Perspectives 1Q 2018

Integrity in Investing
Key Questions for the Informed Investor

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Integrative Wealth Management

"Everybody has some information. The function of the markets is to aggregate that information, evaluate it, and get it incorporated into prices."
– **Merton Miller**, professor and Nobel Laureate economist

This is part of a series exploring integrity in planning financial strategy

Key takeaways:

- Capital markets can work for you using drivers of returns derived from financial science
- Practice smart global diversification, making informed and not speculative decisions
- Focus investing decisions on what you can control, and educate yourself on what matters

At the beginning of 2017, a common view among money managers and economic analysts was that global financial markets would not repeat 2016's strong returns. Many cited the uncertain global economy, political turmoil in the U.S., implementation of Brexit, conflicts in the Middle East, North Korea's weapons buildup, and other factors. Yet equity markets worldwide defied popular predictions, with major U.S. and international indices posting strong returns for the year. Clients once again experienced the advantages of a strategic multi-dimensional structured investing approach based on discipline and diversification versus prediction and timing.

The 2017 markets were a humbling experience for pundits, and reinforced decades of empirical historical evidence that concludes investing out-performance from forecasting cannot be consistently achieved. Attempting to predict markets requires investors not only to accurately forecast future events, but also to predict how markets will react to those events. Speculation is futile. The academic view is that today's security prices reflect both collective expectations of market participants and information about future expected returns of stocks and bonds.

Taking control of your financial future requires taking actions that truly matter. Making smart investment management decisions takes advantage of market price information in academically informed ways. It takes advantage of how diversified investment strategies allow disciplined investors to reliably capture capital markets returns more confidently and have greater peace of mind. The serious investor can gain insight into essential investment concepts and principles from the following questions he may not know to ask.

Exhibit 1: WORLD EQUITY TRADING 2016
(Daily Average)

Number of Trades	Dollar Volume
82.7 MILLION	$346.4 BILLION

Source: World Federation of Exchanges members, affiliates, correspondents, and non-members. Trade data from the global electronic order book. Daily averages were computed using year-to-date totals as of December 31, 2016, divided by 250 as an approximate number of annual trading days.

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1. How much competition do I face as an investor?

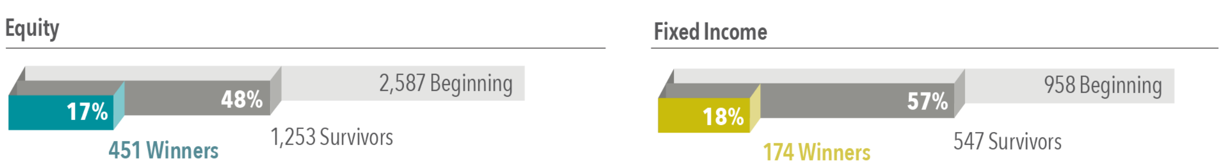
The market is an effective information-processing machine. Millions of market participants buy and sell securities every day and the real-time information they bring helps set prices.

As we see in **Exhibit 1**, this means competition is stiff and trying to outguess market prices is difficult for anyone, even professional money managers (see question 2 for more on this). This is good news for investors though. Rather than participating in conventional methodologies searching for securities that may be priced "incorrectly," investors can instead adopt an approach derived from financial science and rely on the information already in market prices themselves to construct multi-dimensional portfolios through a dynamic implementation process.

2. What are my chances of choosing a winning investment fund that survives and outperforms?

Flip a coin and your odds of getting heads or tails are 50/50. Historically, the odds of selecting an investment fund that was still around 15 years later are about the same. Presumably failed funds had poor performance. Regarding outperformance, the odds are worse. The market's pricing power works against fund managers who try to outperform through conventional stock picking or market timing. One needn't look further than real-world results to see this. Based on empirical research*, only 17% of US equity mutual funds and 18% of fixed income funds have both survived and outperformed their benchmarks over the past 15 years. Outcomes are dramatically worse at 20 and 30 years.

Exhibit 2: US-BASED MUTUAL FUND PERFORMANCE, 2002–2016

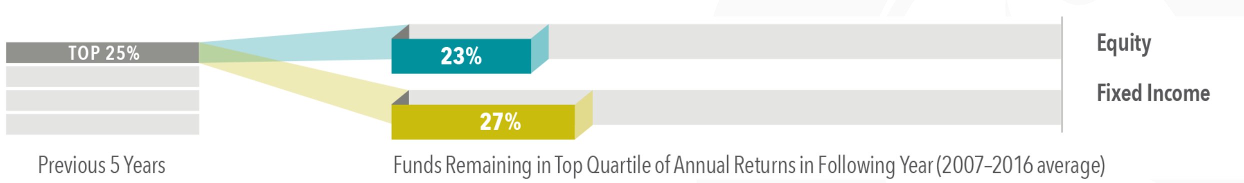


Source: *Mutual Fund Landscape 2017, Dimensional Fund Advisors. See Appendix for important details on the study. Past performance is no guarantee of future results.

3. If I select a fund because of strong past performance, should I expect it will do well in the future?

Some investors select mutual funds based on past returns. However, research shows that most funds in the top quartile (25%) of previous five-year returns did not maintain a top-quartile ranking in the following year. In other words, since previous winners don't persist, past performance offers little insight into any fund's future returns.

Exhibit 3: PERCENTAGE OF TOP-RANKED FUNDS THAT STAYED ON TOP



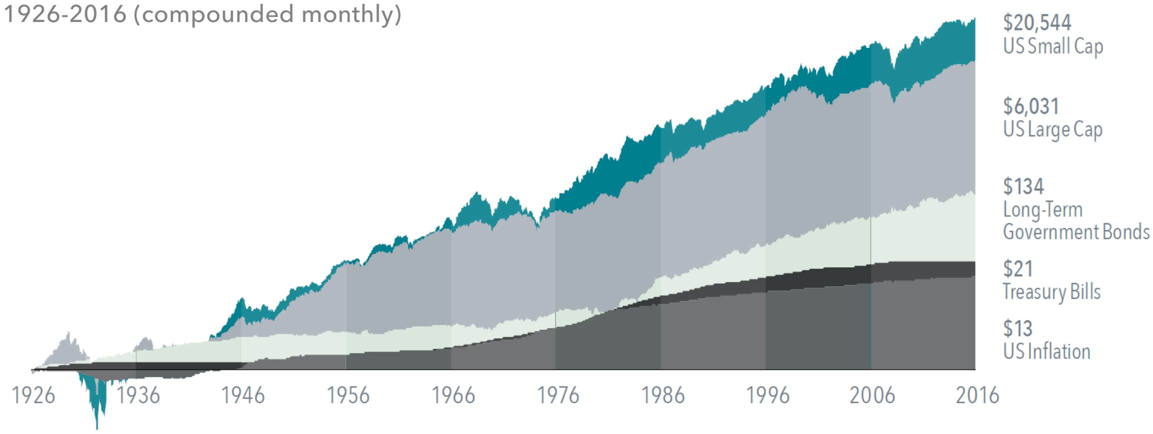
US Small Cap is the CRSP 6–10 Index. US Large Cap is the S&P 500 Index. Long-Term Government Bonds is the IA SBBI US LT Govt TR USD, provided by Ibbotson Associates via Morningstar Direct. Treasury Bills is the IA SBBI US 30 Day TBill TR USD, provided by Ibbotson Associates via Morningstar Direct. US Inflation is measured as changes in the US Consumer Price Index. US Consumer Price Index data is provided by the US Department of Labor Bureau of Labor Statistics. CRSP data is provided by the Center for Research in Security Prices, University of Chicago. The S&P data is provided by Standard & Poor's Index Services Group. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is no guarantee of future results.

4. Do I need to outsmart other investors to be a successful investor myself?

Financial markets have rewarded long-term investors. People expect a positive return on the capital they invest, and historically, the equity and bond markets have provided growth of wealth that has substantially offset inflation. Risk and expected return are related. To get more return, you must take more risk. Instead of fighting markets or other investors, find a way to let them work for you.

Exhibit 4: GROWTH OF A DOLLAR

1926-2016 (compounded monthly)

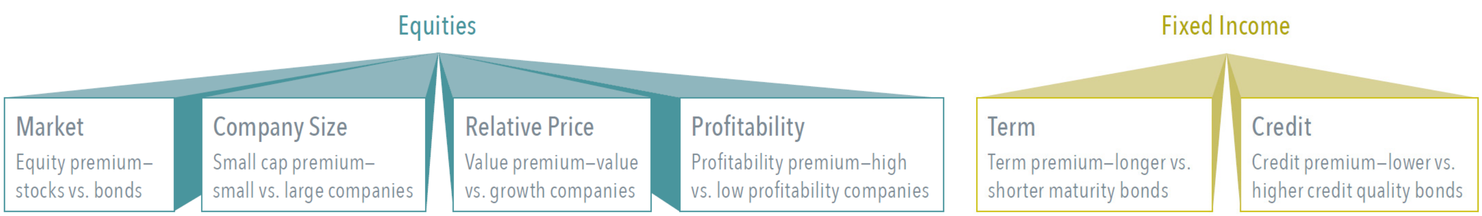


US Small Cap is the CRSP 6–10 Index. US Large Cap is the S&P 500 Index. Long-Term Government Bonds is the IA SBBI US LT Govt TR USD, provided by Ibbotson Associates via Morningstar Direct. Treasury Bills is the IA SBBI US 30 Day TBill TR USD, provided by Ibbotson Associates via Morningstar Direct. US Inflation is measured as changes in the US Consumer Price Index. US Consumer Price Index data is provided by the US Department of Labor Bureau of Labor Statistics. CRSP data is provided by the Center for Research in Security Prices, University of Chicago. The S&P data is provided by Standard & Poor's Index Services Group. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is no guarantee of future results.

5. Is there a less stressful way to manage a retirement portfolio?

Decades of academic research in financial science has identified the equity and fixed income dimensions in **Exhibit 5**. These point to systematic differences in expected returns found among securities around the world. These dimensions are pervasive, persistent and robust, and can be pursued cost-effectively. Instead of stressfully attempting to outguess market prices and market movements, investors can confidently pursue higher expected returns to grow their wealth over time by structuring their portfolio around these dimensions of expected returns.

Exhibit 5: DIMENSIONS OF EXPECTED RETURNS



Relative price is measured by the price-to-book ratio; value stocks are those with lower price-to-book ratios. Profitability is a measure of current profitability based on information from individual companies' income statements.

6. Should I be investing outside the US where it seems more familiar?

Diversification helps reduce risks that have no expected return, but diversifying only within your home country market likely is not enough. Dimensional global diversification can broaden your investment opportunity set. By holding a globally diversified portfolio, investors are well positioned to seek returns wherever they occur. Simply because US markets, particularly growth stocks, have done well for several years does not mean that out-performance will continue.

Exhibit 6: INDEX PORTFOLIOS

Home Market Index Portfolio	Global Market Index Portfolio
 S&P 500 Index 1 Country, 500 stocks	 MSCI ACWI Investable Market Index (IMI) 46 countries, 8,628 stocks

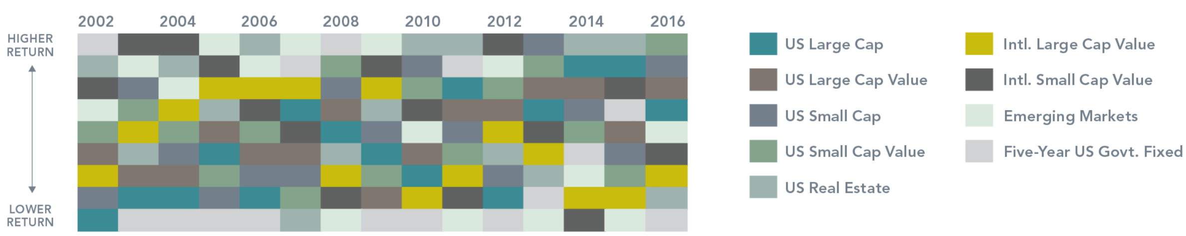
Number of holdings and countries for the S&P 500 Index and MSCI ACWI (All Country World Index) Investable Market Index (IMI) as of December 31, 2016. The S&P data is provided by Standard & Poor's Index Services Group. MSCI data ©MSCI 2017, all rights reserved. International investing involves special risks such as currency fluctuation and political stability. Investing in emerging markets may accentuate those risks. Diversification does not eliminate the risk of market loss. Indices are not available for direct investment.

7. Will frequent changes to my portfolio give me better investment results?

It's tough, if not impossible, to know which market segments or asset classes will outperform from period to period. By holding a globally diversified portfolio, investors are better positioned to capture returns wherever they occur.

Accordingly, it's better to avoid market timing calls and other unnecessary changes that can be costly. This is especially true for taxable portfolios. Allowing emotions or opinions about short-term market conditions to impact long-term investment decisions can lead to disappointing results, especially when related to selling in a declining market or buying into a rising markets. Past performance is not a reliable indicator of future results.

Exhibit 7: ANNUAL RETURNS BY MARKET INDEX



US Large Cap is the S&P 500 Index. US Large Cap Value is the Russell 1000 Value Index. US Small Cap is the Russell 2000 Index. US Small Cap Value is the Russell 2000 Value Index. US Real Estate is the Dow Jones US Select REIT Index. International Large Cap Value is the MSCI World ex USA Value Index (net dividends). International Small Cap Value is the MSCI World ex USA Small Cap Value Index (net dividends). Emerging Markets is the MSCI Emerging Markets Index (net dividends). Five-Year US Government Fixed is the Bloomberg Barclays US TIPS Index 1–5 Years. The S&P data is provided by Standard & Poor's Index Services Group. Frank Russell Company is the source of Russell Indexes. Dow Jones data provided by Dow Jones Indices. MSCI data ©MSCI 2017, Bloomberg Barclays data provided by Bloomberg. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is no guarantee of future results.

8. Should I change my portfolio based on the news or the internet?

Daily market news and commentary can challenge a long-term investment discipline. Some messages stir anxiety about the future, while others tempt you to chase the latest investment fad. If headlines are unsettling, consider the source and try to maintain a long-term perspective.

Many people struggle with their emotions due to their investments. Market go up and down as securities incorporate information into prices. Investors needing peace of mind should seek an investing strategy guided by economic principles and research.

THE PROFESSIONAL WEALTH MANAGEMENT PROCESS™

Phase 1	Phase 2	Phase 3	Phase 4	Phase 5	Phase 6
Progress Envisionment Session	Strategy Commitment Session	Planning Strategy Sessions	Investment Strategy Sessions	Advanced Strategy Sessions	Progress Management Sessions

So, what smart action do I take?

The importance of involvement in a professional wealth management process for long-term success in realizing personal financial goals and circumstances cannot be understated. A wealth management specialist in retirement planning with a proven process can help you take control of your future and gain peace of mind without stressful speculation about uncertainties:

- Envision today the ideal future you want for you and your family tomorrow
- Commit to a financial strategy customized to your needs, goals and dreams
- Develop a process that effectively plans and manages your savings and spending
- Structure and manage your portfolios along the dimensions shown by financial science
- Arrange resources, expenses, and especially taxes to efficiently leverage your efforts
- Stay disciplined to persevere through personal, political, economic and market change

A recognized professional with a proven process and a network of experts in finance, accounting, tax and law experienced in working with successful families like yours can help you develop an integrated strategy. An informed process will put you in control of those key decisions that must be made in an informed way over a lifetime, so you can enjoy an abundant retirement lifestyle, and leave a legacy for family, community, and causes you care deeply about.

The Unexpected is Normal

Financial markets surprised many investors in 2017, but then again markets have a long history of surprising even the smartest experts. We note that from 1926–2017, the annualized return for the S&P 500 Index was 10.2%. *But returns in any single year were seldom close to that average.* A range between 8% and 12% occurred only six times in the last 92 years but gains or losses greater than 20% happened **40 times** (34 gains, six losses). Whatever expected returns people have for a market, realized returns for any year are likely to be wildly different.

For most investors attempting to actively select securities, including professional fund managers, 2017 was a paradox. The harder they tried to enhance their outcomes by closely watching news events, the more likely they failed to capture the rate of return capital markets offered those who stayed with a consistent asset allocation strategy. New Year's resolution: Keep responsibly informed on current events. But let the markets decide where your investment returns will be generated in 2018.

Over the long term, the financial markets have rewarded many investors well. Those saving for the future expect a positive return on the capital they supply—otherwise, why take investment risk at all? Historically, equity and fixed income markets around the world have positively impacted the growth of wealth and made abundant retirements possible for many around the world. As investors plan for 2018 and whatever events the new year may bring, never forget that making investment changes in reaction to news or forecasts will seldom increase wealth.

A firm's cost of capital is the investor's return, as the late Nobel laureate professor Merton Miller was so fond of reminding us. Market risk, especially when managed by firms like Professional Financial through dimensionally diversified strategies, can be your friend, even if success has no guarantee. But like the gasoline in your car or the electricity in your house, used wrongly, risk can damage or even "kill" your future. Investors with serious money don't search salesmen or the internet for fanciful ways of out-performing the market based on headlines, hunches or forecasters. Those who followed The Professional Wealth Management Process™ and saved and spent wisely as they planned, let markets work for them employing an informed strategy, making progress over the years toward their goals and dreams, to realize an abundant retirement.

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Conclusion

Doubtless we will experience yet another a major market debacle in a few years. The world is in a synchronized expansion today due to unexpected changes. Respected valuation metrics suggest that expected return for the US equity markets are near their lowest levels, exceeded only by those of 1929 and early 2000.[1] But timing the market and knowing when to buy and sell at the right time is not possible. That means tactically rebalancing a portfolio back to investment targets and resisting the temptation to keep riding the market higher and putting too much of your portfolio at risk.

The discipline of the wealth management process, after a market big price decline, is to buy back into those beleaguered asset classes. As prices decline, the cost of capital goes up, so expected return is increased. Facing fearful headlines and emotional pain from portfolio declines, the right action takes courage—or at least a process that instills discipline to take the right action and keep doing it.

Looking back ten and twenty years for those clients adopting an early version of our wealth management process, those clients who stuck with their process and stayed on track through market disasters such as the 2001 tech bust or the 2008 financial crisis are enjoying today, or soon entering, their own abundant retirements.

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1 Burton G. Malkiel, How to Invest in an Overpriced World, *Wall Street Journal* (January 22, 2018)

APPENDIX

Question 2: The sample includes US-based funds at the beginning of the 15-year period ending December 31, 2016. Each fund is evaluated relative to the Morningstar benchmark assigned to the fund's category at the start of the evaluation period. Surviving funds are those with return observations for every month of the sample period. Winner funds are those that survived and whose cumulative net return over the period exceeded that of their respective Morningstar category benchmark.

Question 3: At the end of each year, funds are sorted within their category based on their five-year total return. Funds in the top quartile (25%) of returns are evaluated again in the following year based on one-year performance in order to determine the percentage of funds that maintained a top-quartile ranking. The analysis is repeated each year from 2007–2016. The chart shows average persistence of top-quartile funds during the 10-year period.

Questions 2 and 3: US-domiciled open-end mutual fund data is from Morningstar and Center for Research in Security Prices (CRSP) from the University of Chicago. Index funds and fund-of-funds are excluded from the sample. Equity fund sample includes the Morningstar historical categories: Diversified Emerging Markets, Europe Stock, Foreign Large Blend, Foreign Large Growth, Foreign Large Value, Foreign Small/Mid Blend, Foreign Small/Mid Growth, Foreign Small/Mid Value, Japan Stock, Large Blend, Large Growth, Large Value, Mid- Cap Blend, Mid-Cap Value, Miscellaneous Region, Pacific ex-Japan Stock, Small Blend, Small Growth, Small Value, and World Stock. Fixed income fund sample includes the Morningstar historical categories: Corporate Bond, Inflation-Protected Bond, Intermediate Government, Intermediate-Term Bond, Muni California Intermediate, Muni National Intermediate, Muni National Short, Muni New York Intermediate, Muni Single State Short, Short Government, Short-Term Bond, Ultrashort Bond, and World Bond. For additional information regarding the Morningstar historical categories, please see "The Morningstar Category Classifications" at morningstardirect.morningstar.com/clientcomm/Morningstar_Categories_US_April_2016.pdf. See Dimensional's "Mutual Fund Landscape 2017" for more detail. Benchmark data provided by Bloomberg Barclays, MSCI, Russell, Citigroup, and S&P. Bloomberg Barclays data provided by Bloomberg. MSCI data ©MSCI 2017, all rights reserved. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. Citi fixed income indices ©2017 by Citigroup. The S&P data is provided by Standard & Poor's Index Services Group.