

Quarterly Commentary: First Quarter 2005

Your portfolio

Your core portfolio had a modest gross return for this quarter of just under 1%, nicely beating the comparable benchmarks. This performance is in line with what we expected.

An interesting situation occurred in the first quarter with the two small cap funds. It is well established that there is a return premium from owning small cap stocks, along with increased risk, which we handle through diversification. The DFA International Small Capitalization Fund had a 6.4% return while the US Small Capitalization Fund lost 4.6%. This is an example of a short-term anomaly that occurs in investments. I would not expect this to continue where the same asset class performs in an opposite fashion due to geographic differences.

Influential factors

Interest rates in the US were sharply higher during the quarter. The US economy appears to be strengthening. In Canada rates moved up modestly. Economic activity slowed in Canada as the impact of a stronger dollar last year continued to work through the economy.

Strong growth in developing countries has led to a firming of demand for commodities pushing the Commodity Research Bureau Index to record highs. Oil was leading the way.

Is anything new?

This is a frequently asked question, especially with regard to adding hedge funds to portfolios. The short answer is there is nothing new and with hedge funds you do not even get what you pay for. I had some fun with this topic recently. I was interviewed for the National Post in Jonathan Chevreau's personal finance column on March 3 and 22 and on Report on Business television by Jim O'Connell on March 28.

The essence of the articles and TV interview was that nobody can predict the future even if we really hope they can! Why pay a manager huge fees to take risks you do not get compensated for? With your portfolio you are paid for every element of risk you take. Risk is an essential component of your return; our job is to make sure you are paid for it.

To quote Warren Buffet: "Hedge funds are a huge fad. You can pick any ten hedge funds and I'll bet that on average they will underperform the S&P over the next ten years. You can't create more money out of American business than the business itself creates; so most of these hedge funds will not be able to justify their outlandish fees over the long term and they will disappear. On Wall Street there are innovators, imitators and total incompetents. I'm afraid that the majority of hedge funds around the globe now are run by the latter two categories of people."

Research Department

The research to structure and keep your core portfolio efficient and up to date is a huge challenge. Fortunately with the support of Dimensional Fund Advisors you have the best brains in the business. The DFA board is composed of a large portion of the leading financial economists from the best business schools in the world. This group includes Eugene Fama, University of Chicago, Roger Ibbotson, Yale University, and Nobel Laureates Robert Merton, Harvard University and Myron Scholes, Stanford University.

This “brain trust” is constantly working to improve your portfolio. Enhancements are only made after rigorous analysis and research.

Yours sincerely,

David R. Bruce CIMA
Associate Director