

THE RETIREMENT INCOME COMPASS

BECAUSE THERE ARE BIG RISKS ON THE ROAD AHEAD

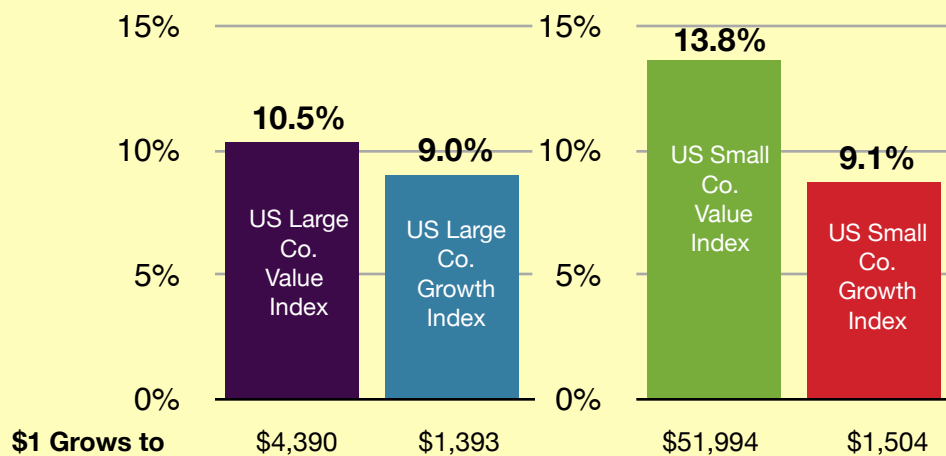
Investing Challenge/Compass Advantage

The Value Effect:

A Premium from Owning What Others Don't Want

Value Stocks Have Had Significant Outperformance Over Growth Stocks

Annualized Returns (%) 1927-2010



Source: Index data provided by Fama/French. Investments cannot be made directly into indexes. Fund trading and advisor fees will reduce index returns. Past performance is no guarantee of future performance.

Evidence from practicing investors and academics points to an undeniable conclusion: returns and risks are related. Gains are rarely accomplished without taking a chance, but not all risks carry a reliable reward.

- Financial science over the last fifty years has brought us to a powerful understanding of the types of risks worth taking. The graphic illustrates the reward of one such risk—The Value Effect.
- Over 84 years U.S. large company *value* stocks outpaced large company *growth* stocks by 1.5 percentage pts./yr., tripling the growth of \$1 (\$4,390 vs. \$1,393).
- U.S. small co. *value* stocks outpaced small company *growth* stocks by 4.7 percentage pts./yr., more than a thirty-fold greater growth of \$1 (\$51,994 vs. \$1,504).
- The rationale for this counterintuitive return/risk performance: Growth companies are relatively stronger (less risk) than value companies (more risk).

Compass Advantage

- 84 years of history shows that investing in value stocks is a risk worth taking.
- Really-smart investors don't buy value stocks one by one. There are almost always valid reasons why any particular value stock is out of favor.
- The best way to buy value stocks is by the thousands through mutual funds that specialize in the value asset classes.
- The ideal value fund would be passively managed (allowing a low expense-ratio) and would have a trading strategy that minimizes transaction costs.
- The value funds managed by Dimensional Funds Advisors (DFA), used in Madden's managed portfolios, meet the criteria described above.
- Madden's managed portfolios are designed to have a bias toward value stocks, but also to have a liberal allocation to growth stocks, both large and small.

DFA's Trading Advantage

Value stocks of both large and small companies are less liquid than growth stocks. The difference in the bid/ask trading spread could quickly erode the expected return premium for value if trading is executed without a careful cost-conscious trading strategy.

DFA's patient, large scale trading brings opportunity for cost-effective and lucrative trades. A vast universe of illiquid stocks is transacted in a coordinated way. The result: performance driven by a potent combination of investment philosophy and trading power.

For more on DFA's trading strategy and tactics, go to:

www.dfaus.com/application/trading/

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What to know...
and how to go

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