How Does Asset Class Investing Differ from Indexing?

Mutual funds and ETFs that try to replicate or track market indexes have gained in popularity in recent years. Index Funds and ETFs now cover everything from major market indexes such as the S&P 500 to particular types of securities such as small cap stocks, value stocks, and REITS, to sectors, even individual countries. While index investing, in our view, is preferable to active management, it has one major problem: Indexes are designed to establish market performance and serve as a benchmark for active management, not serve as investment vehicles. And their drawbacks can reduce their effectiveness in delivering pure asset-class returns.

Indexes are unmanaged baskets of securities that investors cannot directly invest in.

The Origins of Asset Class Investing

Rex Sinquefield and David Booth helped pioneer the first S&P 500 index funds in the early 1970s — Booth at Wells Fargo and Sinquefield at American National Bank. In 1981, determined to improve upon some of the problems they'd encountered with indexing, the two men formed Dimensional Fund Advisors (DFA). With the help of their former professor at the University of Chicago, Eugene Fama Sr., Sinquefield and Booth developed what is known today as asset class investing.

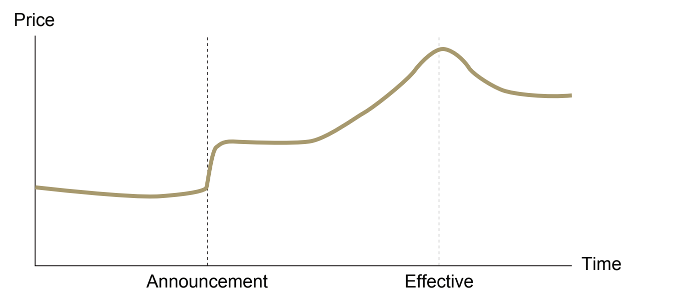
Indexing	Asset Class Investing
Portfolio holdings dictated by target index	Portfolio holdings dictated by academically designed asset class
Attempts to deliver target index rate of return	Attempts to deliver asset class rate of return
Accepts high transactions costs and turnover in favor of tracking	Can help minimize costs and enhance returns through advanced trading and engineering
Manager goal to eliminate tracking error	Manager goal to deliver asset class rate of return

The Potential Benefits of Asset Class Investing vs. Indexing

Efficient Trading

Trading stocks — especially small cap stocks — can be expensive. In DFA's experience, careful trading may result in cost reductions, with savings accruing directly to an investor's return.

As illustrated in the chart on the right, studies have shown that there is a run up in a security's price from the date its inclusion in an index is announced to the date it is actually added. After the effective date, when the security officially



	S&P 500 Index	MSCI EAFE Index
One Day Return after Announcement (%)	3.2	3.4
Run-Up to Effective Date (%)	3.8	4.5
Decay after Effective Date (%)	-2.1	-2.6

In US dollars. S&P 500 data source: Anthony Lynch and Richard Mendenhall, "New Evidence on Stock Price Effects Associated with Changes in the S&P 500 Index," Journal of Business 70, no. 3 (July 1997): 351-83. MSCI EAFE Index data source: Rajesh Chakrabarti, Wei Huang, Narayanan Jayaraman, and Jinsoo Lee, "Price and Volume Effects of Changes in MSCI Indices: Nature and Causes," Journal of Banking and Finance 29, no. 5 (May 2005): 1237-64. For illustrative purposes only. Past performance is not a guarantee of future results.

becomes part of the index, the price of the security tends to decline. Since a key goal of index fund managers is to minimize tracking error, they must purchase the security on the effective date, often at a high price, in order to avoid tracking error. DFA is able to avoid this reconstitution effect by patiently trading securities and not mechanically following indexes; their goal is to deliver the asset class rate of return and not eliminate tracking error.

DFA's trading strategy is also designed to capitalize on block trading and securities lending to add value over conventional indexing strategies.

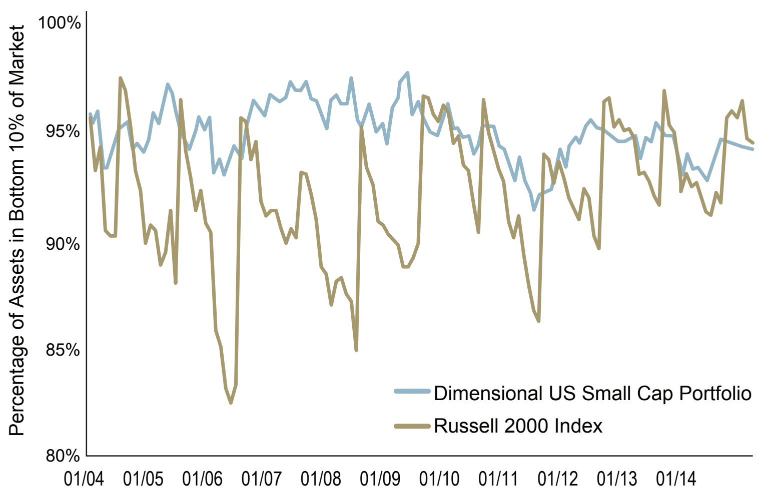
Pure Asset Class Exposure

Over time, securities within an index can migrate from one asset class to another, e.g., from small company to large company. Since many indexes are reconstituted only once a year, their characteristics can be significantly different eleven months after their reconstitution date. Because of this, an index that purports to represent a certain asset class may not offer thorough, consistent exposure to the underlying risk factors. This can be seen in the chart on the right that shows the Russell 2000 Index and the Dimensional US Small Cap Portfolio.

Asset Class investors are able to maintain "pure" asset class exposure. Because Asset Class Investing is not tied to a specific target index, money managers can utilize investor cash flows into and out of the portfolios to hold the necessary securities for each asset class.

Consistency of Asset Class Exposure 2004 - 2014

Percentage of Assets in Bottom 10% of Markets	Russell 2000 Index	Dimensional US Small Cap Portfolio
May 31 Averages (11 months after reconstitutions)	89.10%	95.96%
June 30 Averages (reconstitution month)	95.72%	95.67%



Month-end values from January 2004 - December 2014.
Russell data copyright © Russell Investment Group 1995-2015, all rights reserved. CRSP data provided by the Center for Research in Security Prices, University of Chicago. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results.

A Powerful Combination

Loring Ward has chosen Dimensional to manage the stocks and bonds in its portfolio management programs, based on Dimensional's philosophy, experience and track record. These programs combine Dimensional's expertise in asset class investing along with asset allocation, investment management, an Investment Policy Statement, rebalancing, reporting and a commitment to customization to provide Advisors and investors with a complete portfolio management solution.

Implementing an indexing or asset class investing strategy cannot guarantee a gain or protect against a loss.

Securities in an underlying index or asset class may underperform in comparison to the general securities markets, a particular securities market, or other asset classes. Errors in index data may occur from time to time and may not be identified and corrected for a period of time, and may have an adverse impact on an index fund and its shareholders.

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