



Are You Earning Market Returns?

This is one of the first questions we ask investors when we begin discussing the benefits of a passive investment strategy with them. **Believe it or not, most investors do not earn market returns due to excessive fees, poor diversification, trying to time the market, excessive taxes or a combination of all of these.** A recent study by Dalbar, Inc., a Boston-based research firm, showed that for the 20 year period between 1989 and 2009, the S&P 500 had an annualized return of 8.21% while the average investor earned only 3.17%. That's a lot of money left on the table. Why? If the market offered those returns for just participating, why didn't investors take advantage of them? Many investors try to "outsmart" the market in an attempt to capture "alpha" or excess returns above what you would expect to earn given the risks taken. They try to "time the market" by moving in and out of investments and, inevitably, they let their emotions (fear and greed) dictate their investment decisions. What many people consider to be investing, we would say is, in fact, speculating.

True investing means participating in capitalism in a disciplined, patient manner. In a market-based economy, investors commit funds to businesses to help them grow and thrive with the expectation of sharing in the profits that are generated. Capital markets must generate rewards for those investors over the long term or people would stop investing and capitalism would cease to exist. **Passive investing is a disciplined strategy for capturing the returns that the global capital markets provide to investors who are willing to commit their financial resources.** These returns are available to all investors who choose to accept them.

We have listed below the 2010 performance data for some of the major asset classes (Source: Dimensional Fund Advisors). Clients at Passive Capital Management, LLC have allocations to these market segments in customized portfolios designed to meet their own financial objectives within their own appropriate risk/reward framework.

Asset Class Performance – 2010

U.S. large company equities: +15.0%	International developed small company equities: +23.9%
U.S. large value equities: +20.2%	International developed large company equities: +9.3%
U.S. small company equities: +30.7%	International developed large value equities: +10.6%
U.S. small value equities: +30.9%	Emerging markets blended equities: +23.6%
U.S. diversified real estate: +28.7%	U.S. 1-3 Year Treasury bonds: +2.3%

In the results above for 2010, stocks performed better than Treasury bonds, small company stocks performed better than large company stocks and value stocks performed better than growth stocks. Academics (Eugene F. Fama and Kenneth R. French) have identified the following **three risk factors as the dimensions of returns: market (stocks vs bonds), size (small vs large) and value (value vs growth).** These are systematic risks that, over time, investors are likely to be compensated for taking. Eighty years of data confirm that over the long term, stocks outperform bonds, small companies outperform large companies and value companies outperform growth companies. This is true across the globe.



Incorporating these risk factors into portfolios is one way Passive Capital Management, LLC's investment strategy of asset class fund investing may differ from traditional do-it-yourself index fund investing. Some traditional index funds do a good job of capturing the performance of a particular asset class but not all asset classes are represented by index funds. Regardless of what investment products are used to structure your portfolio, it is critical that you own them in appropriate quantities and proportions given your investment objectives and risk tolerance. **Great tools are helpful but what really matters is how you use them.**


The trend toward passive investing continued in 2010 as more passive investment vehicles were launched and existing passive products, as a group, gained market share versus active products. The competition across products has benefited our clients through broader investment options and lower product costs. **Instead of competing with the capital markets, we believe the best opportunity for investors to enjoy a successful investment experience is to take advantage of what the markets offer.**

The Passive Capital Management, LLC investment philosophy is founded on the following core principles:

- **Asset allocation will be the primary determinant of performance.**
- **Diversification will improve risk-adjusted returns for most investors.**
- **Expected returns are a function of systematic risk.**
- **Costs matter.**
- **Tax efficiency will matter for many investors.**
- **Disciplined rebalancing ensures that you maintain an appropriate level of risk throughout all phases of the market cycle.**
- **Liquidity and transparency matter – every PCM portfolio is liquid and transparent.**

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