Wealth Management Plan, Part Two: Investment Policy Statement

Prepared for Mr. and Mrs. Affluent Client

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Our Investing Approach

Our investing process centers around five steps:

1. Assess your goals and circumstances. The investment plan process begins during the Discovery Meeting with a discussion of your financial values and goals, as well as your key relationships, existing assets, other professional advisors, preferred process and important interests.

2. Set long-term investment objectives. Taking into account the long-term nature of successful investing, we set objectives for your portfolio that are appropriate for your willingness, ability and need to take risk, and the investment horizon(s) you identify.

3. Plan your asset allocation. Because it is so important, asset allocation is the first investment decision. During this process, we decide how much of your portfolio to invest in each of the different investment types, or asset classes, including stocks, bonds and short-term investments, both domestic and foreign.

4. Select your investment approach. With an asset allocation in place, we now select the investment vehicles that you will use to implement your portfolio strategy. Two key investing principles guide these decisions: the importance of diversification and the value of remaining invested.

5. Build your portfolio. Building on the first four steps, we construct a portfolio suited to your needs, goals, investment horizon and risk attitude. The building blocks for the portfolio are institutional asset class funds, an excellent way to implement a diversified portfolio investment so as to maximize the probability of achieving your goals.

The result of this process is a diagnostic report of your current situation with our recommendations for repositioning your portfolio to maximize your probability for success. In addition to the above considerations, these recommendations take into account portfolio costs as well as the potential tax impact of the restructuring.

Step One: Assess Your Goals and Circumstances

Long-term investment success means different things to different people. The best investment plan for you depends on your specific circumstances and objectives. That is why we began the investment planning process with a discussion during our Discovery Meeting of your values, goals, relationships, assets, advisors, preferred process and interests.

While everyone's situation is unique, certain factors matter in creating any investment plan. These factors include the purpose of the investment, its size, the sources and planned uses of the funds, and the amount of uncertainty you are comfortable having. By thinking clearly about your goals and circumstances, you build the foundation of an investment plan that best matches your needs and the realities of the financial markets.

Step Two: Set Your Long-Term Investment Objectives

Investors know they should be long-term investors. This often gives rise to the question "How long is long term?" The answer for many investors is surprising—your long-term horizon should be as far into the future as possible. One of the many surprising facts about investing is that having a long horizon is a powerful advantage. You want your horizon to be as long as possible, because as an investor, time is your best friend.

For many investors, the most important long-term goal is to achieve financial freedom in order to be able to do what they want. But many investors also have intermediate-term goals—funding college educations for their children, buying vacation homes and founding charitable foundations are but three examples. Investors may also have goals that reach far into the future—for example, they may wish to leave legacies to their children, grandchildren and even great-grandchildren.

Regardless of the time horizon of your goals, the simple fact remains that the more time you have, the more likely you are to succeed as an investor. Why? There are two reasons. The first is the miracle of compound growth, and the second is the phenomenon of risk reduction over time.

The Miracle of Compound Growth

Compound growth operates on a very simple principle. When you put money aside to earn returns, and then reinvest those returns, you have both your original investment and the returns working for you. The longer you allow this process to continue, the greater your accumulation will likely be. Imagine putting $1 million into an investment that consistently earns 8 percent every year. The table below shows how the compounding process works.[1]

Year	Starting Amount	Earnings	Ending Amount
1	$1,000,000	$80,000	$1,080,000
2	$1,080,000	$86,400	$1,166,400
3	$1,166,400	$93,312	$1,259,712
10	$1,999,005	$159,920	$2,158,925
20	$4,315,701	$345,256	$4,660,957

At 8 percent, your investment would grow to more than 4½ times its original size in 20 years. To see the effect of compounding, notice that you would earn $1,158,925 in returns in the first ten years, but even more in the second ten years—$2,502,032.

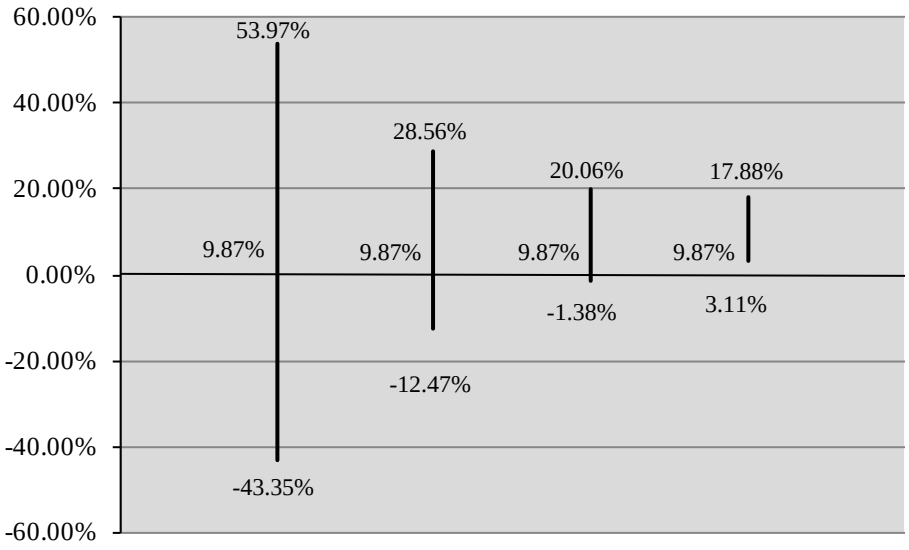
While many people are familiar with the concept of compound growth, they may not be so strongly aware that time actually also helps reduce investment risk, especially in diversified portfolios of stocks. It is natural to worry that if you invest in the stock market today, it may go down tomorrow. But if you have a long investment horizon, tomorrow is just one of the thousands of market days during which you will be investing. Over long periods of time, many of the ups and downs in the market are cancelled out, leaving the broad market trend.

The following graph shows how the range of annualized outcomes for U.S. large capitalized stocks narrows as your horizon becomes longer. It shows results based on the annual performance of Standard & Poor's 500 Index from 1926 to 2010.[2] The market has produced a wide range of outcomes. An investor holding stocks for just one calendar year could have had returns ranging from a high of 53.97 percent to a low of -43.35 percent. An investor with a ten-year horizon could have experienced annualized returns ranging from a high of 20.06 percent to a low of -1.38 percent. Investors would have had to have been invested for 240 months to have had all time periods result in positive returns.

[1] Figures are for illustrative purposes only and are not a guarantee of future performance. Figures do not reflect the effect of fees or taxes.

[2] U.S. large capitalized stock performance calculations are based on annual performance of the Standard and Poor's 500 Index, an unmanaged index intended to represent the performance of a diversified portfolio of large cap U.S. stocks.

Standard & Poor's 500 Index
Overlapping Returns Annualized
Annual: 1926–2010



	1 Year	5 Year	10 Year	20 Year
Highest Return	53.97%	28.56%	20.06%	17.88%
Annualized Return (1926 - 2010)	9.87%	9.87%	9.87%	9.87%
Lowest Return	-43.35%	-12.47%	-1.38%	3.11%

As much as time can reduce your risk, many investors looking at this chart would still feel that the stock market by itself is too risky. In designing your portfolio, we will make use of asset allocation beyond just one asset class, U.S. large capitalized stocks, in order to further significantly reduce risk.

However, it's important for you to have a long-term perspective with any equity portfolio. The minimum expected investment period should be five years for any portfolio containing equity securities. For any portfolio with less than a five-year horizon, the portfolio should be comprised predominantly of fixed-rate investments. This five-year minimum investment period is important in that the investment process must be viewed as part of a long-term plan for achieving the desired results. This is because one-year volatility can be significant for certain asset classes. However, over a five-year period, volatility is greatly reduced. A time horizon of ten years or longer will serve to increase the likelihood of achieving your financial goals even more.

Your Attitudes Toward Risk

While we can do a great deal to mitigate risk, we cannot eliminate it. In any investment plan, it is important to understand both the types and the amount of risk you are taking and to be sure that you are comfortable with these. This understanding will greatly increase your ability to adhere to your long-term investment plan and increase your chances of achieving your financial goals.

The right level of risk for you depends on both your personal preferences and your situation. We break the risk equation into the following four parts:

1. Risk Tolerance: Your Response to Market Fluctuations

Over the course of your investment life, the value of your portfolio will rise and fall. While we would always rather see our portfolio value rise, a prudent investor knows that any investment will have some periods in which the value will fall. Equity markets, in particular, are very volatile and investors must expect that there will be regular periods of rising prices and regular periods of falling prices.

Your risk tolerance describes your level of comfort in waiting through the downturns. If the risk you take is within your risk tolerance, then you will be able to maintain your investment strategy through both strong markets and weak ones, giving you the best chance of investment success.

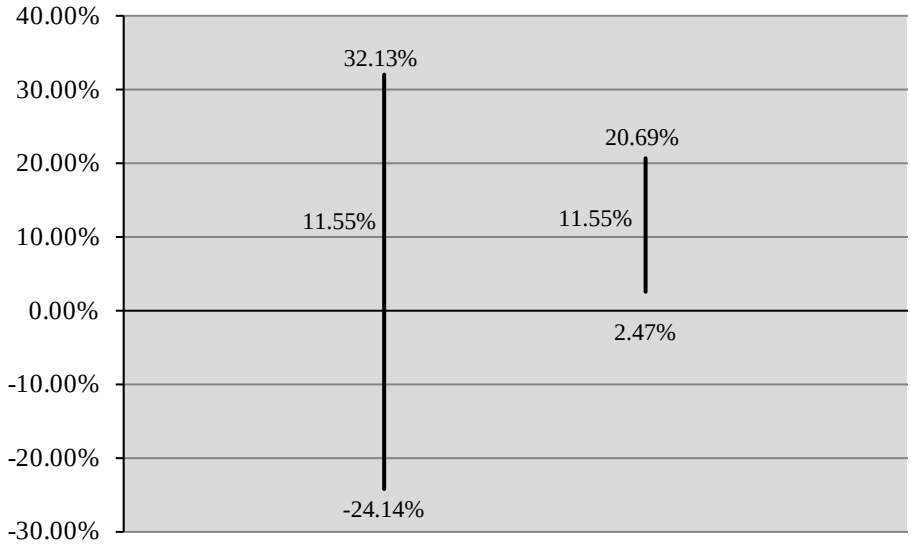
2. Risk Aversion: Your Vulnerability to Losses

Designing an appropriate investment strategy requires understanding and weighing factors that can be in conflict. Your tolerance for risk may be high, but as a prudent investor, you should consider your ability to withstand financial losses. Because market downturns are unpredictable, you need to assess the real economic harm you might face if your portfolio seriously declined in value. If your portfolio failed to provide the returns you had planned for, would you need to adjust your goals?

The chart below shows the best and worst one- and five-year returns of a model portfolio of investment strategies utilizing index asset classes since 1973.[3] As you can see, the longer your time horizon, the greater your ability to withstand risk.

[3] Dimensional Fund Advisors Normal Balanced Strategy is composed of 60 percent equity investments and 40 percent fixed investments. See appendix for detailed breakdown and disclosures. See page 31 for allocation information.

Normal Balanced Indexed Strategy (60% Equity, 40% Fixed Income)
Overlapping Returns Annualized
Annual: 1973– 2010



	1 Year	5 Year
Highest Return	32.13%	20.69%
Annualized Return (1926 - 2010)	11.55%	11.55%
Lowest Return	-24.14%	2.47%

3. Risk Avoidance: Your Need to Take Risk

Most investors would not choose to take more risk than is necessary. While this is a simple statement, investors often fail to build this concept into their investment planning. Your need to take risk is directly tied to your rate-of-return objective.

If you need your portfolio to grow more quickly over your time horizon, you will want a higher rate of return. An increase in your rate-of-return objective, however, will generally mean taking more risk. If your return objective is higher than your risk tolerance (willingness to take risk) or your risk aversion (your vulnerability to losses), then you must adjust one or more of these parameters. This could mean, for example, retiring later and possibly subjecting yourself to the discomfort of greater risk or increasing your savings.

On the other hand, if your rate-of-return objective can be lowered because your assets can support your goals with less growth, then your need to take risk is reduced and your portfolio should be allocated accordingly. As your portfolio grows over time, your need to take risk should be reassessed and your investment strategy adjusted accordingly.

4. Your Tolerance for Tracking Error: Your Ability to Have Your Portfolio Look Different from Popular Indices

Many investors are more comfortable when they know they are doing as well, or as poorly, as most other investors. A portfolio that tracks the returns of a popular index such as the S&P 500 can provide that

comfort, despite the fact that it may not provide the risk management or higher returns that may be available from an effectively diversified portfolio.

Tracking error is the amount by which the performance of a portfolio differs from that of major market indices. You should understand your personal tolerance for the tracking error that can result from a portfolio that purposely diversifies away from popular indices in order to decrease volatility and increase expected returns.

Bear in mind that tracking error can be present over lengthy periods. If, for example, your portfolio is weighted heavily toward value asset classes because of the expected higher return over time, it will often look quite different from the S&P 500 index, which is composed primarily of growth stocks. The difference can be either positive or negative, and may be present over many years.

Rate-of-Return Objective

Every investment choice you make involves a tradeoff between risk and return. In general, a portfolio of safer investments will have less growth potential than a riskier one. To increase the rate-of-return objective, you will typically have to take more risk. Thus, your rate-of-return objective must match the realistic opportunities that you have, given your time horizon and ability to take risk. If your rate-of-return objective is higher than your time horizon and risk attitude permit, then you must adjust one of the three parameters.

All other things being equal, you would most likely prefer to have a higher return. In particular, if two portfolios were equally risky, but one made a higher rate-of-return objective feasible, then you would choose the more rewarding portfolio. One way to construct a rate-of-return objective is to find the portfolio that offers the highest possible rate-of-return objective for your time horizon and risk attitude. In the language of the academic study of investments, this is an *efficient portfolio*.

Over a long investment horizon, a modest increase in your rate of return can make a significant difference in the amount you accumulate. The table below shows the sum to which an initial investment of $1 million will grow over 10 and 20 years at rates of return ranging from 2 percent to 10 percent.[4]

Rate of Return	Initial investment	Balance After 10 years	Balance After 20 years
2%	$1,000,000	$1,218,994	$1,485,947
4%	$1,000,000	$1,480,244	$2,191,123
6%	$1,000,000	$1,790,848	$3,207,136
8%	$1,000,000	$2,158,925	$4,6609,57
10%	$1,000,000	$2,593,743	$6,727,500

Step Three: Plan Your Asset Allocation

If you have been careful in setting your long-term investment objectives, then you can be successful in planning your investments. Once we have worked with you to determine your time horizon and risk attitude, and satisfied you with a feasible rate-of-return objective that will meet your needs, we can begin the task of building your investment portfolio. The first step in this process is asset allocation.

Asset allocation is the process of deciding how much of your portfolio to invest in each of the different

[4] Figures are for illustrative purposes only and are not a guarantee of future performance. Figures do not reflect the effect of fees or taxes.

investment types, or asset classes—stocks, bonds and short-term investments (both domestic and foreign), as well as hard assets such as real estate. Asset allocation should be your first investment decision because it is the most important.

To investigate how important asset allocation really is, three leading American investment experts performed a comprehensive statistical study to measure the importance of various factors in determining a portfolio's performance. They studied the results of 91 major corporate pension plans over a ten-year period which included both good and bad markets. Their conclusion was that, on average, 94 percent of the variability in returns could be explained by the plans' long-term asset class policy (see chart below). The remainder was attributable to individual security selection (4 percent) and market timing (2 percent).[5] However, even though security selection and market timing explained 6 percent of the variability of returns, the overall contribution to performance was negative. The average plan lost 0.66 per year from market timing decisions and another 0.36 percent from security selection. The authors conclude: "Because of its relative importance, investment policy should be addressed carefully and systematically by investors."

Determinants of Investment Portfolio Performance

We thus see the importance of investing for the long term, regardless of the management style. This is true because an investment plan's success cannot be fully realized until the underlying portfolio has gone through the various economic and market cycles that will be experienced over a long period, such as ten years.

Equities vs. Fixed Income

The most basic asset allocation choice is between equities and fixed-income investments. Equities represent participation in the long-term growth of companies and of the economy, while fixed-income investments represent fixed obligations of governments and corporations. It seems natural, then, that equities should offer superior long-term growth potential, while fixed-income investments offer more stability. The choice of allocation between equities and fixed income is a clear example of the basic investment tradeoff between

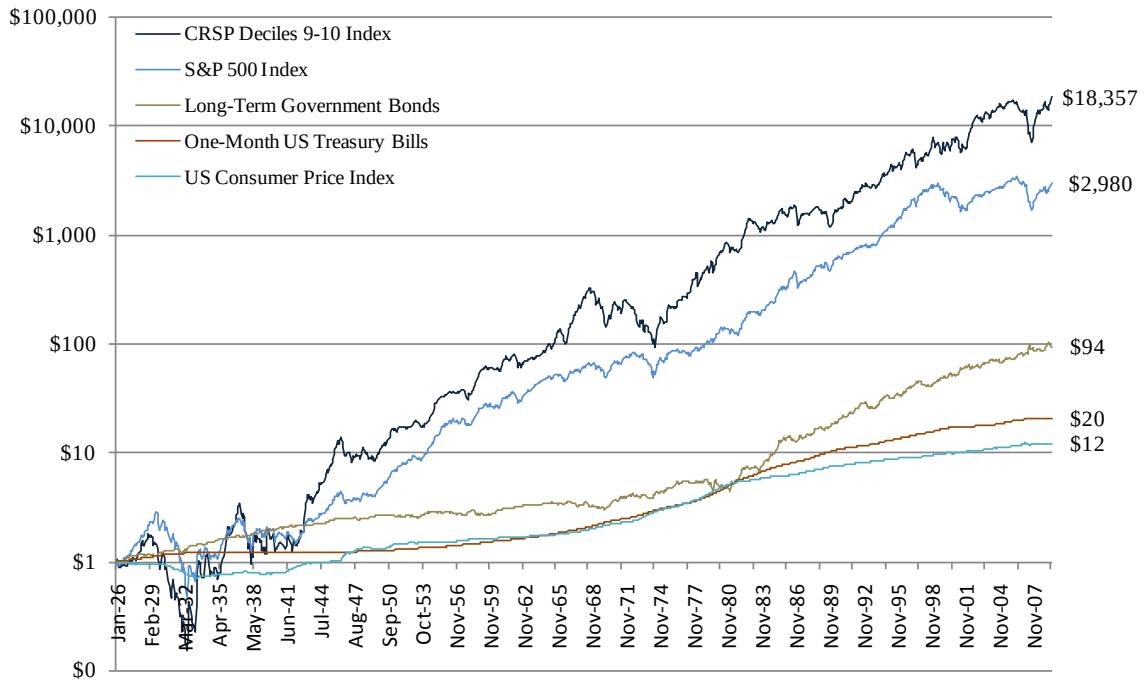
[5] Gary P. Brinson, L. Randolph Hood and Gilbert L. Beebower, "Determinants of Portfolio Performance," *Financial Analysts Journal*, July/August 1986.

risk and return.

In exploring asset classes, we begin with the historical performance of investment categories. This is not to say that the past indicates future performance; however, it does indicate reasonable relationships between various asset classes.

By referring to the graph below, you can see that historically, equities have far outperformed fixed-income securities. For example, one dollar invested in common stocks (as represented by the S&P 500 Index) at the beginning of 1926 would have been worth $2,980 (assuming reinvestment of dividends) by the end of 2010, while an investment in small company stocks would have been worth $18,357. Fixed-income vehicles have trouble even keeping pace with inflation. That same dollar invested in 20-year U.S. government bonds would have been worth $94. If invested in 30-day U.S. Treasury Bills, this dollar would have been worth $20. Simply to maintain purchasing power (to stay even with inflation) an investor over this period would have required an increase in value to $12.[6]

Stocks, Bonds, Bills and Inflation
January 1926–December 2010



Modern Portfolio Theory, which we will discuss in more depth later, would suggest that investments in equities would be likely to continue to produce higher returns than those in fixed income, given the higher risks inherent in equity markets. These risks are primarily due to the cyclical swings of the stock markets.

These cyclical swings are of greatest concern to those who will have to liquidate their investments in the near future. In light of your long-term perspective, it is prudent to attempt to achieve a higher rate of return by investing a large portion of your portfolio's assets in equities.

That said, there is often a place for both equities and fixed-income investments in a prudently-designed portfolio. In a strongly-rising stock market, some investors are tempted to move to an all-equity portfolio in

[6] Roger G. Ibbotson and Rex Sinquefield, *Stocks, Bonds, Bills, and Inflation*. Dow Jones Irwin, Homewood, IL. 1986. Updated annually by Ibbotson Associates.

order to capture those gains. However, such a move can result in dramatic swings in the portfolio's value, and may leave the portfolio vulnerable to a substantial drop in value once the market has ceased its run-up.

Likewise, other investors, who are near or in retirement, often wish to remain "safe"—to protect themselves from stock market swings—by holding an all-fixed income portfolio. However, as we note below, such a portfolio will tend to achieve returns only approximately equal to the rate of inflation. Without the inflation-beating potential of equities, such a portfolio is subject to a gradual erosion of its value over time.

The bottom line: Building a prudent portfolio requires careful consideration of the unique characteristics of both equities and fixed income and what each can add to the portfolio.

Fixed-Income Investments

As the long-term returns figures show, an all-equity portfolio has attractive growth potential, but significant uncertainty about the exact outcome. For this reason, we describe an all-equity portfolio as being aggressive. It is most suitable for investors who are willing and need to take substantial risk in the pursuit of reward.

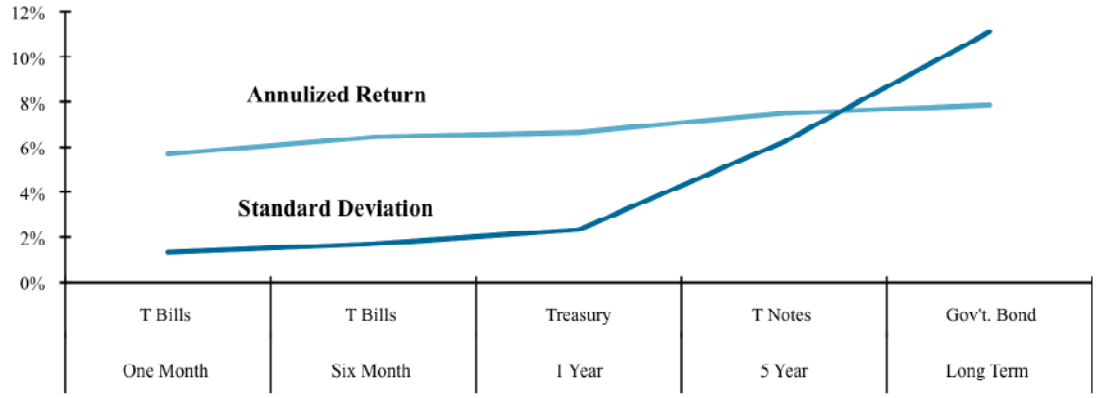
Investors with shorter investment horizons, a high level of risk aversion or less need to take risk should maintain portfolios that are significantly less aggressive than the all-equity strategy. For these investors, some portion of the portfolio should remain in fixed-income instruments. Bonds provide income and help reduce the overall risk in a portfolio. However, because of the fixed nature of the income stream from a bond, there is comparatively little upside potential in a bond portfolio. Investors are sometimes surprised to learn that bond prices can rise and fall with changes in interest rates, but the main source of investment returns from bonds are the interest payments they make.

A portion of your portfolio's assets will be invested in high-quality fixed-income investments. Fixed-income investments will help reduce the overall level of risk in your portfolio, because fixed-income investments tend to be less risky than equities, and because the fixed-income investments represent an additional diversification of your assets. Fixed-income instruments should be used to reduce the overall level of risk to your comfort level. It is important to note that over the long term, fixed-income investments will typically have returns approximate to inflation.

The fixed-income investments for the portfolio will be in either short- or intermediate-term bonds. Research by Eugene Fama at the University of Chicago and other respected academicians has shown that long-term bonds historically have had wide variances in their rates of total return without sufficiently compensating investors with higher expected returns.[7] In terms of variability of total return, long-term bonds look more like stocks than shorter-term fixed-income vehicles such as Treasury bills. Yet, over long time periods, their respective total returns have consistently lagged behind those of equities. A look at the following graph will help illustrate the higher standard deviations (volatility) and lower total returns of bonds with maturities beyond five years.[8]

[7] For example, see Edward L. Martin, "Intermediate-Term Bonds," *AAII Journal*, January 1991, pp. 13-16.
[8] Treasury instruments 1964-2010: DFA Returns program, Ibbotson & Assoc. Standard deviation annualized from quarterly data.

Risk and Return Examined for Bonds
1964–2010



Our purpose in holding some fixed-income investments is to mitigate the risk (volatility) of your overall portfolio. Subject to a given level of risk, we believe a combination of equities and high-quality, short- to intermediate-term fixed-income instruments is the most effective way to achieve your objective of maximizing returns. Replacing the traditional long-term bond holding with a combination of equities and short- to intermediate-term fixed-income vehicles should maintain the portfolio's expected rate of return while decreasing its volatility.

Equity Investments

We will focus your portfolio's equity investments in "asset class funds" or close proxies for asset class funds. An asset class fund is a mutual fund designed to broadly represent the market, or some significant segment of the market (such as the stocks of large companies or the stocks of emerging foreign markets). These funds invest in a large number of the stocks of their defined segment of the market to provide returns closely approximating the returns offered by that particular segment. By using asset class funds, we hope to lower risk by increasing diversification, achieve market segment returns and minimize costs. By choosing the asset classes that have the highest expected return, we hope to equal the total market's performance with less volatility.

Domestic Equity Investments

We have chosen as our domestic equity asset classes stocks of the U.S.'s largest capitalized companies and

U.S. small stocks. We chose these because these groups have the highest expected returns and because academic research shows that the largest and smallest companies' stocks have low correlation with each other. In other words, in most investment periods, these two asset classes would be the best and worst performers.[9] Building a portfolio containing asset classes with low correlation to each other has been shown to provide greater long-term performance for the investor, while reducing risk through diversification.

The following table highlights the best and worst performing deciles.[10] You can see that the largest movements have generally occurred in the largest and smallest deciles.

It is well documented that, historically, stocks of smaller companies have outperformed the market as a whole. For instance, stocks whose capitalization puts them in the lowest quintile of all stocks (as represented by the CRSP Deciles 9 and 10) have had an annualized return of 13.28% percent over the 85 years ending in 2010. It is well above the annualized return of 9.87 percent for the S&P 500 Index over the same period.[11]

	CRSP Deciles - Annualized Returns (%)									
Time	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
1927 - 1929	18.60%	18.20%	12.29%	7.10%	15.99%	-1.63%	4.45%	0.33%	-4.07%	0.27%
1930 - 1932	-26.72%	-32.10%	-30.43%	-32.57%	-33.53%	-30.95%	-34.62%	-35.91%	-35.16%	-28.51%
1933 - 1935	28.30%	42.86%	44.02%	51.26%	52.14%	53.99%	58.92%	80.49%	74.28%	98.57%
1936 - 1938	3.42%	4.30%	1.92%	2.52%	5.00%	4.16%	1.99%	0.59%	6.22%	-5.23%
1939 - 1941	-4.52%	-6.86%	-5.71%	-4.58%	-3.91%	-3.46%	-3.45%	-6.50%	-7.64%	-12.81%
1942 - 1944	17.95%	28.00%	25.42%	31.03%	36.30%	36.38%	45.47%	49.04%	61.72%	93.82%
1945 - 1947	9.31%	12.44%	12.43%	13.41%	12.51%	13.46%	11.21%	11.44%	15.49%	16.54%
1948 - 1950	16.57%	17.37%	17.84%	15.43%	16.58%	16.80%	17.53%	15.06%	16.16%	22.47%
1951 - 1953	11.96%	12.16%	10.89%	8.78%	7.25%	7.44%	8.36%	4.58%	4.70%	0.12%
1954 - 1956	27.17%	25.06%	26.41%	25.19%	25.86%	27.51%	26.38%	24.59%	27.85%	27.69%
1957 - 1959	12.77%	14.47%	15.12%	17.96%	17.21%	13.75%	18.82%	16.68%	20.87%	17.69%
1960 - 1962	4.95%	6.62%	5.99%	4.47%	1.87%	1.09%	0.87%	2.66%	1.32%	1.28%
1963 - 1965	15.67%	18.28%	20.38%	19.15%	20.09%	23.96%	22.26%	22.84%	19.73%	24.39%
1966 - 1968	5.58%	9.89%	14.41%	17.34%	21.49%	24.10%	23.60%	32.52%	34.99%	45.93%
1969 - 1971	3.43%	0.13%	3.08%	-1.10%	-2.90%	-2.17%	-6.42%	-9.51%	-12.27%	-13.23%
1972 - 1974	-8.47%	-12.96%	-13.96%	-17.05%	-16.74%	-18.97%	-20.72%	-20.63%	-23.99%	-25.12%
1975 - 1977	13.17%	22.35%	28.96%	32.95%	36.65%	38.35%	42.31%	47.20%	44.59%	49.74%
1978 - 1980	17.60%	20.96%	24.05%	24.60%	26.09%	31.55%	31.33%	31.10%	32.78%	33.36%
1981 - 1983	9.76%	11.37%	16.63%	18.20%	20.07%	20.26%	17.87%	21.36%	21.38%	24.08%
1984 - 1986	18.89%	20.56%	15.46%	14.45%	13.69%	13.43%	12.60%	9.48%	7.97%	0.56%
1987 - 1989	17.06%	16.09%	16.75%	15.27%	13.19%	12.35%	10.11%	11.68%	5.88%	2.80%
1990 - 1992	10.62%	12.55%	13.10%	12.53%	17.08%	14.06%	13.33%	10.01%	12.39%	10.88%
1993 - 1995	15.03%	14.59%	14.62%	14.96%	15.28%	14.31%	15.53%	14.05%	15.11%	16.71%
1996 - 1998	31.15%	20.64%	16.26%	17.20%	9.70%	15.10%	15.60%	13.95%	12.78%	8.23%
1999 - 2001	-2.98%	2.58%	6.09%	5.11%	4.36%	9.80%	7.96%	13.53%	15.04%	14.74%
2002 - 2004	1.73%	10.78%	10.07%	12.11%	10.88%	12.49%	11.36%	15.62%	16.26%	29.24%
2005 - 2007	8.72%	11.61%	10.16%	8.92%	11.06%	7.57%	8.21%	6.21%	3.80%	4.45%
2008 - 2010	-3.37%	-0.75%	2.38%	3.42%	6.72%	2.57%	6.48%	8.25%	6.74%	7.34%

Best
Worst

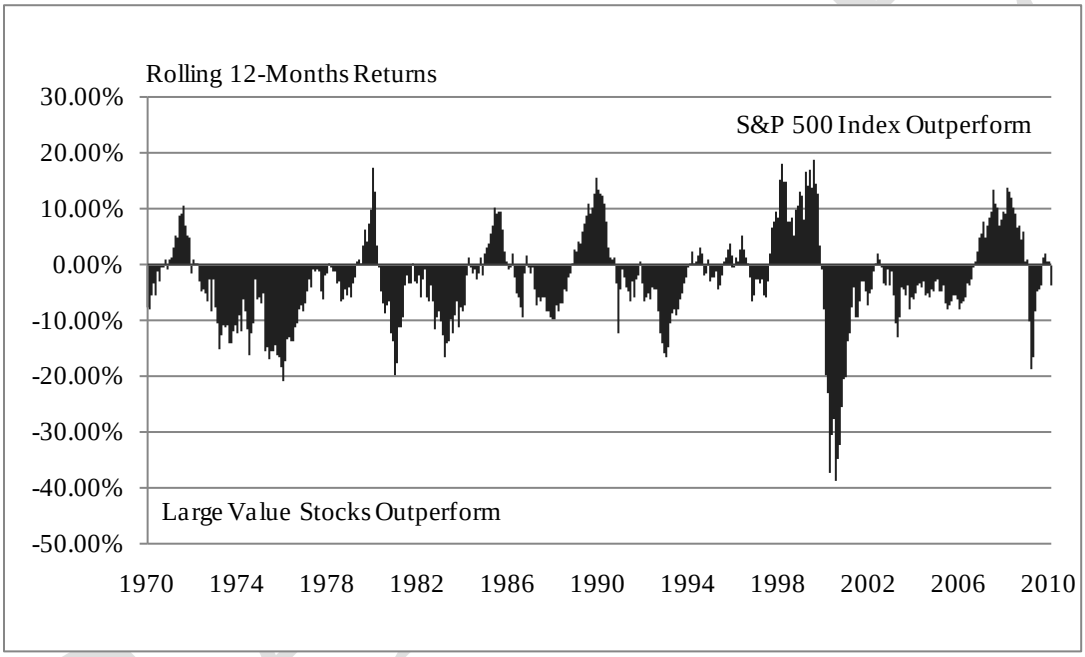
Growth vs. Value

[9] Dimensional Fund Advisors, *U.S. Small Company Strategy*.
[10] Deciles 1-10 of NYSE (plus AMEX equivalents since July 1962 and NASDAQ equivalents since 1973). CRSP: Center for Research in Security Prices, University of Chicago.
[11] Dimensional Fund Advisors, DFA Returns program, as updated through 2010.

Another important issue to consider when allocating equities in a portfolio is the distinction between growth stocks and value stocks. Growth stocks are generally regarded as those that are expected to grow at an above-average rate when compared to the market as a whole. In contrast, value stocks are generally considered by many to be the "bargains" of the market because they tend to trade at lower prices relative to their fundamentals, such as dividends and earnings.

Because the two styles are so different, it's unusual that they both work well at the same time. The following chart shows the importance of diversifying between both growth and value stocks.[12] Investment returns in value stocks have outperformed growth stocks at irregular intervals, which emphasizes the importance of maintaining a style-diversified portfolio.

U.S. Growth and Value Styles Performed Differently
Monthly: January 1970–December 2010



International Equity Investments

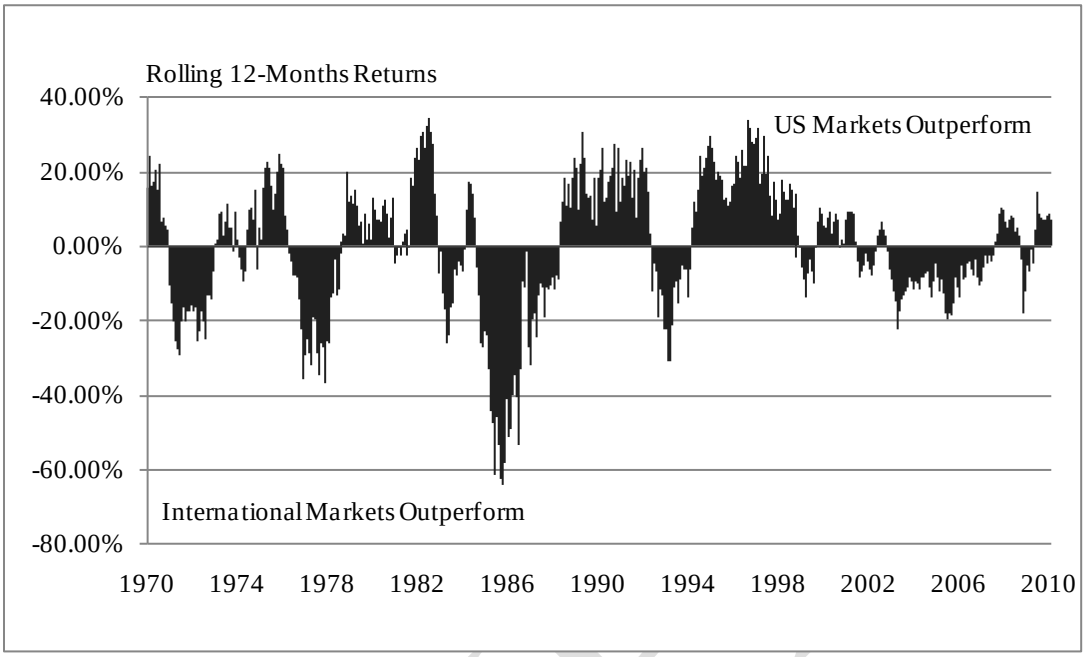
The international and U.S. markets also have low correlation. In addition to taking advantage of the high returns attainable in the U.S. equity markets, your portfolio will invest in overseas equity markets. The primary reason for this is increased diversification, which is meant to lower risk. The correlation between the performance of the Japanese, United Kingdom, European/Continental and Pacific Rim stocks and that of the U.S. stocks is lower than the correlation between the large and small segments of the U.S. market. Thus, by diversifying internationally, you can lower the volatility of your portfolio by combining asset classes with low correlation, while still enjoying the superior returns of the equity markets.

The chart below shows the importance of global diversification.[13] Investment returns in foreign markets have outperformed domestic-market returns at irregular intervals, which emphasizes the importance of

[12] The difference between the S&P 500 Index and the Dimensional U.S. Large Value Index. Monthly annualized returns.
[13] The difference between the S&P 500 Index and the Morgan Stanley EAFE Index. Monthly annualized returns.

maintaining a globally diversified portfolio.

U.S. and Foreign Markets Perform Differently
Monthly: January 1970 – December 2010



When two investments have similar long-term returns, and yet have such dissimilar patterns in their short-term outcomes, you can then preserve your portfolio's growth potential and reduce risk at the same time by investing in both.

A segment of your portfolio will be invested in asset class funds comprised of stocks of small companies outside of the U.S. The small-firm effect has been identified in foreign equity markets as well as in the United States. In fact, available evidence implies that the effect is even stronger in the major foreign markets (i.e., higher return and lower risk).[14]

The important thing to realize is that mixing domestic and foreign stocks is a powerfully advantageous investment strategy. While investors all over the world tend to emphasize investments in their own home markets, if you do not invest in overseas equities at all, you miss two important benefits. First, overseas investments allow you to participate in the growth of the whole global economy. Second, international equities are a powerful diversifier, allowing you to reduce risk without sacrificing the growth potential of equity investments. By investing in small stocks and value stocks overseas, your portfolio will gain even greater diversification from the domestic equities you hold.

Emerging Market Equity Investments

Most global portfolios include a small portion in emerging markets. In today's world of equity investing, we are seeing a great deal of growth in emerging markets. The growth rates in these markets have been significantly greater at times than the rate of growth found in established markets. Research indicates that a very small position in emerging markets can increase the return of the portfolio without increasing overall portfolio volatility. In fact, because of the low correlation between the emerging-market asset class and the other asset classes, the overall portfolio volatility can be reduced.

[14] Dimensional Fund Advisors, Inc., "International Small Company Stocks—A New Dimension for Institutional Investors" (1987); also "International Small Companies," a DFA presentation (1990). Updated, 2002.

In order to minimize the risk of investing in the inherently riskier realm of emerging markets, we choose funds that have established stringent selection criteria in choosing appropriate countries to include in this asset class.

Criteria for Country Selection

In order to be considered for inclusion in the emerging-market asset class, a country must have the following:

1. A relatively stable political environment
2. A well-organized financial market
3. A market that provides ample liquidity for its shares
4. A sound legal system that protects property rights and upholds contractual obligations

While these markets are defined as *emerging*, the companies within the asset class are well-established companies in those countries. Typical holdings are the national banks, the land developers and telephone companies of the various countries concerned.

Step Four: Select Your Investment Approach

As noted previously, the most important factor determining your investment outcome will be your asset allocation. Once you have determined your asset allocation, the next step is to select the investment vehicles that you will use to implement your portfolio strategy. Two important principles of Modern Portfolio Theory should guide this selection: (1) Diversify and (2) Stay invested.

Elements of Modern Portfolio Theory

The basis for the principles of your investment plan is a collection of the best evidence from the academic disciplines of economics and finance. Investment experts usually summarize this evidence as a body of knowledge called “Modern Portfolio Theory.”

The foundation of Modern Portfolio Theory was a 1952 paper, “Portfolio Selection,” by Dr. Harry Markowitz, in which he established a theory explaining the best way for an investor to choose a portfolio. His basic theory was that investors should choose a portfolio that offers the best return for a given level of risk—the efficient portfolio mentioned previously. Later work by contributors such as Dr. William Sharpe added to our understanding of how to choose the best portfolio from among a specific set of securities.

Modern Portfolio Theory is of such fundamental importance in investing that the economists who formulated the theory received the Nobel Prize in Economic Science in 1990. In addition, most states have adopted Modern Portfolio Theory as the foundation for the prudent-investor rules that govern standards for trustees.

Modern Portfolio Theory has four basic premises. The first is that investors are inherently risk averse. Investors are not willing to accept risk, except where the level of returns generated will compensate them for that risk. Investors are often more concerned with risk than they are with reward.

The second premise is that the securities markets are efficient. Most studies support this idea. In fact, advancing information technology and increased sophistication on the part of investors are causing the markets to become even more efficient.

The third is that the focus of attention should be shifted away from individual securities analysis to consideration of a portfolio as a whole, predicated on the explicit risk/reward parameters and on the total portfolio objectives. The efficient allocation of capital in your portfolio to specific asset classes will be far more important than selecting the individual investments.

The final premise of Modern Portfolio Theory is that for every risk level there is an optimal combination of asset classes that will maximize returns. Quantitative methods can be used to measure risk and to diversify effectively among asset classes. Portfolio diversification is not so much a function of how many individual stocks or bonds are involved as it is of the relationship of each asset to every other asset. The percentage and the proportionality of these assets in the portfolio are of paramount importance.

1. Diversify

One reason why many investors are reluctant to invest much in the stock market is that they know many stories of companies and stocks that have suddenly fallen on hard times. Some investors imagine an investment in the stock market to be like that—when a stock has gone very high, it may be just the time that it is about to fall sharply. The mistake they make when they think this way is that they forget that while a single stock may rise or fall dramatically, the movements of the overall market are generally much more subdued.

Modern Portfolio Theory provides the reason. It explains that two effects govern the movements of every stock market and stock-specific events. It is primarily the stock-specific events that cause individual stocks to move up or down wildly relative to the overall market. You may think that your best protection against stock-specific risk is to have portfolio managers that know all the companies in your portfolio well. The trouble is, the events that cause the most damage to stocks usually come as a complete surprise. A company may have a sudden product liability problem, or the chairman may die or come under a cloud. On the upside, the company may make a surprise new product announcement, or land a major contract. These events are often unanticipated, and so they cause price movements that not even the best portfolio managers can expect. In fact, Modern Portfolio Theory tells us that if the market can anticipate an event, then the effect of the event is already evident in the stock's price, and no further profit from knowledge of the event is possible.

If it is surprising that portfolio managers cannot anticipate a stock's movement, then how can an investor protect a portfolio against them? The answer is diversification. The stock-specific movements of individual stocks may not be predictable, but over a diversified portfolio, they tend to cancel one another out.

Modern Portfolio Theory tells us that we can build diversified portfolios to greatly reduce stock-specific risk, but that market events, which affect all stocks, are not diversifiable. That is, even a diversified portfolio of stocks is subject to the overall movements of the market. Fortunately, the theory predicts that the market rewards us for taking this risk by giving us generous long-term growth potential. The asset allocation decision is where we decide how aggressively to pursue this long-term growth.

2. Stay Invested

Investors often ask when is the right time to enter the market. For a long-term investor, the answer is today. There is no short-term investment opinion behind that statement. No one can predict the movements of the market for the next month or year.[15] Just as with unanticipated events, if portfolio managers could somehow predict the future movement of the market, then prices in the market would already reflect that knowledge, and so it would be impossible to profit from it.

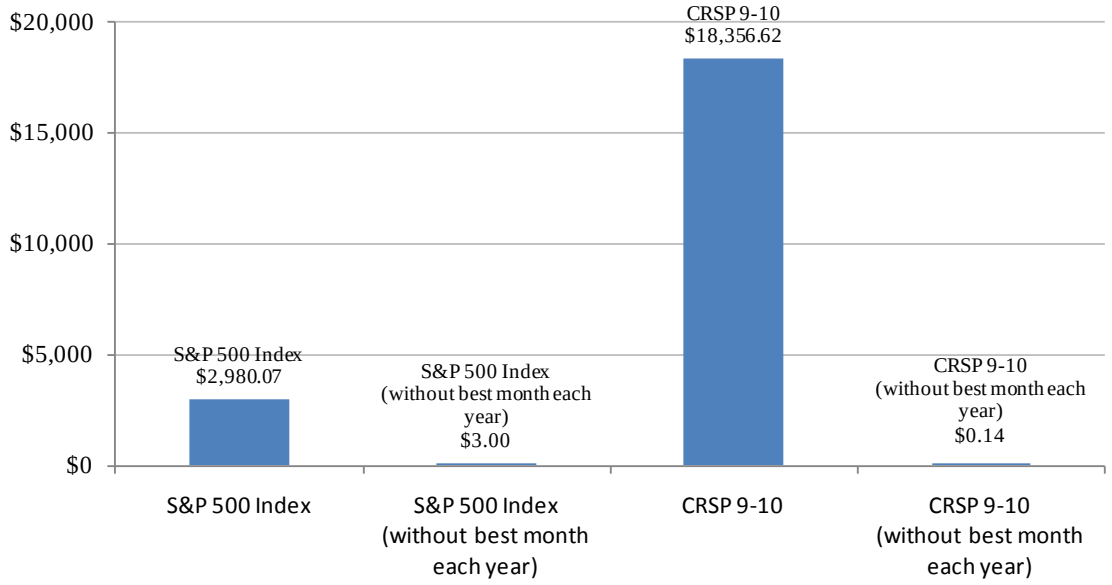
Even though there is always a danger that the market will go down tomorrow, today is the right day to start

[15] For an intelligent and entertaining discussion of this issue, see Burton R. Malkiel, *A Random Walk Down Wall Street.*

investing. The next chart shows why. A large proportion of the long-term gain in investment in the stock market comes from sharp upward bursts. Just missing the best month out of each calendar year over the past 80 years would have resulted in dramatically lower returns than staying invested throughout the period. A dollar invested January 1, 1926, in the S&P 500 would have accumulated to $2,980 by December 31, 2010. If you had not been invested during the best month out of each calendar year, your one-dollar investment in 1926 would have grown only to $3.00 over the following 85 years.

The opportunity costs are even more dramatic with small company stocks. Investing a dollar in the small company index of The Center for Research and Security Prices (CRSP 9-10) in 1926 would have grown to $18,357 by the end of December 2010. If you had simply not been invested in the best month out of each calendar year, your one-dollar investment would not have grown at all over the next 85 years. Instead, it would have dropped in value to just 14 cents.[16] Smart investors stay invested for the long term.

Growth of $1 invested in January 1926 through December 2010
Market Gains Are Very Concentrated



Step Five: Build Your Portfolio

For most people, building a truly diversified portfolio is difficult. Imagine that you wanted to build a diversified portfolio of 500 stocks worldwide. To do a good job, you may need to have $5 million or more to invest. Many investors do not have, or choose to invest, this much.

Even if you have enough money to build a diversified portfolio, you may not have enough time. Choosing 500 stocks that you can buy with confidence is difficult enough. Once you had bought the stocks, you would still have a lot of work ahead of you. You would receive masses of information on a large number of companies, and you would have to review your portfolio regularly to decide whether it still suits your objectives. It would be a lot of work to even calculate the performance of your portfolio and decide whether it was good or bad.

[16] The S&P data are provided by Standard & Poor's Index Services Group. CRSP data provided by the Center for Research in Security Prices, University of Chicago.

An easier way to implement a diversified portfolio is through institutional asset class funds. By buying an institutional asset class fund, in a single transaction you invest in a broad diversified portfolio in a specific asset class. These institutional asset class funds combine your investment with those of other investors to build up a pool of money large enough to buy a diversified portfolio. The portfolio manager's full-time job is making sure that the securities in the portfolio continue to be suitable for the fund's investment objective.

Initial Asset Classes

The asset classes below have been selected from the asset classes available that meet the outlined constraints, are suitable for your risk tolerance and can assist you in reaching your financial goals.[17]

Asset Class	Annualized Return (%) (January 1999-December 2010)	Annualized Standard Deviation (%) (January 1999-December 2010)
DFA Enhanced US Large Company Portfolio Class I	1.91	4.67
DFA US Large Cap Value Portfolio Class I	5.66	5.60
DFA US Micro Cap Portfolio Class I	10.00	6.77
DFA US Small Cap Value Portfolio Class I	11.12	6.39
DFA Real Estate Securities Portfolio Class I	10.78	6.82
DFA International Value Portfolio Class I	7.76	5.82
DFA International Small Company Portfolio Class I	10.93	5.27
DFA International Small Cap Value Portfolio Class I	12.45	5.44
DFA Emerging Markets Portfolio Class I	14.69	6.80
DFA Emerging Markets Value Portfolio Class I	19.22	7.67
DFA Emerging Markets Small Cap Portfolio Class I	18.55	7.25
DFA One-Year Fixed Income Portfolio Class I	3.56	0.25
DFA Two-Year Global Fixed Income Portfolio Class I	3.70	0.31
DFA Short-Term Government Portfolio	4.90	0.93
DFA Five-Year Global Fixed Income Portfolio Class I	4.72	0.82

Integrated vs. Component Approach

In some cases overall performance may be enhanced by replacing several asset-class funds with a single "core" equity mutual fund. Core strategies employ the same principles of broad diversification and precisely defined characteristics but offer the potential to reduce tax and transactions costs associated with holding ten or more separate mutual funds in a portfolio. The table below shows four broadly diversified core equity funds each of which represents a blend of the characteristics associated with specific asset class component funds. Overall portfolio performance is unrelated to the number of funds in a portfolio—what matters is the number of underlying stock holdings and their characteristics. The core strategies are carefully engineered to capture a specific combination of characteristics associated with several distinct asset class funds.

[17] Source: Dimensional Fund Advisors, Inc. Performance data represents past performance and does not predict future performance. The investment return and principal value will fluctuate, so that an investment's shares, when redeemed, may be worth more or less than their original cost. Furthermore, there can be no assurance that any of the portfolios will achieve their investment objective. Total returns include reinvestment of dividends and capital gains.

Component Approach (asset class funds)	Integrated Approach (core funds)
DFA Enhanced US Large Company	DFA US Core 1 or DFA US Core Equity 2
DFA US Large Cap Value	
DFA US Micro Cap	
DFA US Small Cap Value	
DFA Real Estate Securities	DFA Real Estate Securities
DFA Large Cap International	DFA International Core Equity
DFA International Value	
DFA International Small Company	
DFA International Small Cap Value	
DFA Emerging Markets	DFA Emerging Markets Core Equity
DFA Emerging Markets Small Cap	
DFA Emerging Markets Value	
DFA One-Year Fixed Income	DFA One-Year Fixed Income
DFA Two-Year Global Fixed Income	DFA Two-Year Global Fixed Income
DFA Five-Year Government	DFA Five-Year Government
DFA Five-Year Global Fixed Income	DFA Five-Year Global Fixed Income
DFA Selectively Hedged Global Fixed Income	DFA Selectively Hedged Global Fixed Income

Expected Rate of Return

The term “expected return” is a term of specialized use, which is generally understood to mean the statistically achievable return (based on historical data) over a sufficiently long-time horizon. Expected returns are theoretical returns. They are not estimated returns and are in no way indicative of actual or future performance. In administering the managed portfolios, the expected rate of return of each asset class is the forecast arithmetic annual mean for the next five years. The expected rate of return is recalculated quarterly. These forecasts have been developed using the Capital Asset Pricing Model concept, originally developed by Nobel Prize-winning financial economist William Sharpe of Stanford University. The longest possible time series data have been used, in conjunction with generally accepted investment principles, to arrive at theoretically valid expected returns and standard deviations. (For some asset classes, data is available as far back as 1926.)

Standard Deviation

The standard deviation is a measure of volatility. In general, the higher the standard deviation, the greater the volatility or risk. An asset class’s annual total return can be expected to fall within one standard deviation of its expected rate of return roughly two-thirds of the time, and within two standard deviations approximately 95 percent of the time. In other words, an asset class with a one-year standard deviation of 5 percent and an expected return of 8 percent would be expected to vary between +13 percent and +3 percent (±5 percent) about 68 percent of the time, and between +18 percent and -2 percent (±10 percent) about 95 percent of the time.

Correlation Coefficients

The correlation coefficients reveal the predictability of one asset class, given the knowledge of another. Correlation coefficients are measured on a scale from “+1.000” to “-1.000”, where “+1.000” indicates that

both asset classes always move in the same direction. A measurement of "-1.000" indicates that both asset classes always move in opposite directions. A measurement of zero indicates no measurable relationship between the two asset classes.

In constructing your portfolio, it is critical to include asset classes with low correlation coefficients. The correlation coefficients of each of the asset classes are illustrated below.[18]

Correlation Coefficient Factors
January 1999–December 2010

Asset Class	DFA Enhanced US Large Company	DFA US Large Cap Value	DFA US Micro Cap	DFA US Small Cap Value	DFA Real Estate Securities	DFA International Value	DFA International Small Company	DFA International Small Cap Value	DFA Emerging Markets	DFA Emerging Markets Value	DFA Emerging Markets Small Cap	DFA One-Year Fixed Income	DFA Two-Year Global Fixed Income	DFA Short-Term Government	DFA Five-Year Global Fixed Income
DFA Enhanced US Large Company	1.00														
DFA US Large Cap Value	0.89	1.00													
DFA US Micro Cap	0.74	0.67	1.00												
DFA US Small Cap Value	0.79	0.84	0.94	1.00											
DFA Real Estate Securities	0.57	0.70	0.59	0.70	1.00										
DFA International Value	0.82	0.84	0.68	0.79	0.66	1.00									
DFA International Small Company	0.73	0.73	0.71	0.76	0.59	0.92	1.00								
DFA International Small Cap Value	0.72	0.76	0.68	0.77	0.63	0.93	0.99	1.00							
DFA Emerging Markets	0.80	0.76	0.72	0.75	0.52	0.83	0.82	0.80	1.00						
DFA Emerging Markets Value	0.78	0.75	0.70	0.73	0.52	0.83	0.84	0.81	0.99	1.00					
DFA Emerging Markets Small Cap	0.76	0.73	0.70	0.73	0.52	0.83	0.85	0.82	0.97	0.98	1.00				
DFA One-Year Fixed Income	-0.14	-0.18	-0.20	-0.25	-0.09	-0.10	-0.09	-0.08	-0.14	-0.11	-0.12	1.00			
DFA Two-Year Global Fixed Income	-0.18	-0.22	-0.24	-0.28	-0.06	-0.14	-0.12	-0.11	-0.15	-0.13	-0.14	0.92	1.00		
DFA Short-Term Government	-0.23	-0.26	-0.23	-0.26	-0.06	-0.16	-0.10	-0.09	-0.17	-0.15	-0.15	0.66	0.78	1.00	
DFA Five-Year Global Fixed Income	-0.15	-0.17	-0.20	-0.22	0.05	-0.10	-0.03	-0.03	-0.11	-0.09	-0.09	0.65	0.80	0.90	1.00

Manager Selection for Each Asset Class

Many investors feel that they could have earned better returns than they did during the last few years. Unfortunately, most investors are using the wrong tools and put themselves at a significant disadvantage to institutional investors.

Almost all investors would benefit by using institutional asset classes. An asset class is a group of investments whose risk factor and expected returns are similar. Originally, institutional asset class funds were not available to individual investors. Often, the minimum investment for these mutual funds was in the millions of dollars, effectively removing them from reach from all but the wealthiest investors. That was their goal because these funds were for institutional accounts, such as large pension plans. Working with our firm provides our investors with access to these institutional asset class funds.

There are four major attributes of institutional asset class funds that attract institutional investors:

1. Lower Operating Expenses

All mutual funds and separately managed accounts have expenses that include management fees, administrator charges and custody fees. These are expressed as a percentage of assets. The average annual expense ratio for all retail equity mutual funds is 1.33 percent.[19] In comparison, the same ratio for asset

[18] Source: Dimensional Fund Advisors, Inc.
[19] Morningstar Direct Mutual Fund Database, December 2010.

class funds is typically only about one-third of all retail equity mutual funds. All other factors being equal, lower costs lead to higher rates of return.

2. Lower Turnover Resulting in Lower Cost

Most investment managers do a substantial amount of trading, believing that this adds value. The average retail mutual fund has a turnover ratio of 95 percent.[20] This means that, on average, 95 percent of the securities in the portfolio are traded over a 12-month period. This represents approximately $950,000 of traded securities for every $1,000,000 invested.

High turnover is costly to shareholders because each time a trade is made there are transaction costs, including commissions, spreads and market-impact costs. These hidden costs may amount to more than a fund's total operating expenses if the fund trades heavily or if it invests in small company stocks whose trading costs are very high.

Institutional asset class funds have significantly lower turnover because their institutional investors want them to deliver a specific asset class return with as low cost as possible.

3. Lower Turnover Resulting in Lower Taxes

If a mutual fund sells a security for a gain, it must make a capital gains distribution to shareholders because mutual funds are required to distribute 98 percent of their taxable income each year, including realized gains to state tax-exemption at the corporate level. They distribute all their income annually because no mutual fund manager wants to have his or her performance reduced by paying corporate income taxes.

In one study, Stanford University economist John B. Shoven and Joel M. Dickson[21] found that taxable distributions have a negative effect on the rate of return of many well-known retail equity mutual funds. They found that a high-tax-bracket investor who reinvested the after-tax distribution ended up with an accumulated wealth per dollar invested of only 45 percent of the fund's published performance. An investor in the middle tax bracket realized just 55 percent of the published performance.

Because institutional asset class funds have less turnover, they often have significantly lower tax.

4. Consistently Maintained Market Segments

Most investment advisors agree that the largest determination of performance is asset allocation—how your money is divided among different asset categories. However, you can only accomplish effective asset allocation if your investments in your portfolio maintain consistent asset allocation. That means your funds need to stay within their target asset classes. Unfortunately, most retail funds effectively have you relinquish control of your asset allocation as they overweight particular parts of the market in their quest to achieve higher rates of return than the market as a whole. In contrast, because of their investment mandates, institutional asset classes must stay fully invested in the specific asset class they represent.

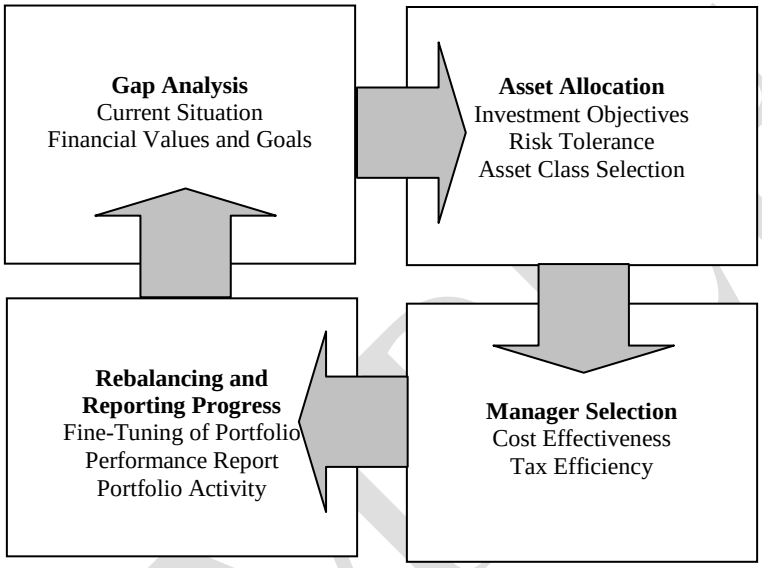
Fortunately, we can now make these institutional asset class funds available to our clients. You can gain the same advantages that previously only large institutional investors received.

[20] Morningstar Direct Mutual Fund Database, December 2010.

[21] A study, commissioned by Charles Schwab and conducted by John Shoven, a Stanford University economics professor, and Joel Dickson, a Stanford PhD candidate, measured the performance of 62 equity funds for the 30-year period from 1963 through 1992.

Strategic Portfolio Management Process

The financial goals and values you shared with us at our Discovery Meeting have become the basis for your investment plan, as well as our Strategic Portfolio Management Process. This is not a one-time event, however. The Strategic Portfolio Management Process that we use is constantly ongoing to ensure that we are on track to achieve those goals and values. It is vital in managing the investment component of your overall wealth management plan. The process has four distinct parts, as illustrated below.



Gap Analysis

This is an ongoing evaluation of your current situation. We reassess where you are now, where you want to go, and consider any actions or changes that may be necessary to maximize the probability of achieving all that is important to you.

Asset Allocation

As we have discussed, we use Modern Portfolio Theory to determine that your account has the proper asset class selection to meet your financial goals. Change is one thing of which we are certain, and because proper asset allocation is so important, we periodically review each asset class to determine if it is still appropriate to your overall plan.

Manager Selection

While decisions about asset allocation are the most important decisions to be made about your portfolio, we also evaluate the managers on an ongoing basis. In particular, we look for their ability to deliver consistent returns within their asset class in a cost-effective and tax-efficient manner.

Rebalancing and Reporting Progress

During our Regular Progress Meetings, we will ask you about any specific events in your life that may call for a change in your portfolio. These events might include, for example, the birth of a child or grandchild, the death of a parent or a change in your marital status. When changes in your situation indicate that changes and rebalancing in your portfolio are warranted, we make these as needed.

We will also report on how your portfolio has performed, as well as specific activity in the portfolio, at our Regular Progress Meetings.

Comparative Index Returns

January 1, 1970–December 31, 2010: SINGLE-YEAR PERIODS

1 Year Ending	Inflation	T-Bills	T-Bonds	S&P 500 Index	Small Co. Stocks	EAFE Index	Int'l Small Co. Stocks
Dec-70	5.5%	6.5%	12.1%	4.0%	-16.8%	-11.7%	0.9%
Dec-71	3.4%	4.4%	13.2%	14.3%	17.7%	29.6%	68.3%
Dec-72	3.4%	3.8%	5.7%	19.0%	-1.4%	36.3%	64.2%
Dec-73	8.8%	6.9%	-1.1%	-14.7%	-40.8%	-14.9%	-13.7%
Dec-74	12.2%	8.0%	4.4%	-26.5%	-26.8%	-23.2%	-28.6%
Dec-75	7.0%	5.8%	9.2%	37.2%	71.5%	35.4%	49.9%
Dec-76	4.8%	5.1%	16.8%	23.8%	53.4%	2.5%	11.5%
Dec-77	6.8%	5.1%	-0.7%	-7.2%	21.8%	18.1%	74.1%
Dec-78	9.0%	7.2%	-1.2%	6.6%	22.4%	32.6%	65.5%
Dec-79	13.3%	10.4%	-1.2%	18.4%	43.7%	4.8%	-0.8%
Dec-80	12.4%	11.3%	-4.0%	32.4%	34.6%	22.6%	35.5%
Dec-81	8.9%	14.7%	1.9%	-4.9%	8.2%	-2.3%	0.1%
Dec-82	3.9%	10.5%	40.4%	21.4%	27.2%	-1.9%	0.0%
Dec-83	3.8%	8.8%	0.7%	22.5%	34.1%	23.7%	36.1%
Dec-84	4.0%	9.8%	15.5%	6.3%	-14.0%	7.4%	11.6%
Dec-85	3.8%	7.7%	31.0%	32.2%	28.3%	56.2%	67.5%
Dec-86	1.1%	6.1%	24.5%	18.5%	3.2%	69.4%	59.5%
Dec-87	4.4%	5.5%	-2.7%	5.2%	-13.8%	24.6%	40.7%
Dec-88	4.4%	6.4%	9.7%	16.8%	21.9%	28.3%	25.9%
Dec-89	4.6%	8.4%	18.1%	31.5%	8.2%	10.5%	30.8%
Dec-90	6.1%	7.8%	6.2%	-3.1%	-27.4%	-23.4%	-17.9%
Dec-91	3.1%	5.6%	19.3%	30.5%	50.1%	12.1%	5.8%
Dec-92	3.0%	3.5%	9.4%	7.6%	28.1%	-12.2%	-20.6%
Dec-93	2.8%	2.9%	18.2%	10.1%	20.1%	32.6%	34.4%
Dec-94	2.7%	3.9%	-7.8%	1.3%	-3.1%	7.8%	14.8%
Dec-95	2.7%	5.6%	31.7%	37.6%	33.2%	11.2%	1.0%
Dec-96	3.3%	5.2%	-0.9%	23.0%	19.2%	6.0%	2.8%
Dec-97	1.7%	5.3%	15.9%	33.4%	24.0%	1.8%	-14.5%
Dec-98	1.6%	4.9%	13.1%	28.6%	-8.2%	20.0%	10.2%
Dec-99	2.7%	4.7%	-9.0%	21.0%	31.5%	27.0%	30.2%
Dec-00	3.4%	5.9%	21.5%	-9.1%	-13.4%	-14.2%	-12.3%
Dec-01	1.6%	3.8%	3.7%	-11.9%	33.6%	-21.4%	-16.7%
Dec-02	2.4%	1.6%	17.8%	-22.1%	-13.9%	-15.9%	-2.9%
Dec-03	1.9%	1.0%	1.4%	28.7%	78.2%	38.6%	60.2%
Dec-04	3.3%	1.2%	8.5%	10.9%	16.6%	20.2%	32.1%
Dec-05	3.4%	3.0%	7.8%	4.9%	3.7%	13.5%	22.6%
Dec-06	2.5%	4.8%	1.2%	15.8%	18.0%	26.3%	26.3%
Dec-07	4.1%	4.7%	9.9%	5.5%	-7.9%	11.2%	8.0%
Dec-08	0.1%	1.7%	25.8%	-37.0%	-41.5%	-43.4%	-47.1%
Dec-09	2.7%	0.1%	-14.9%	26.5%	60.7%	31.8%	44.8%
Dec-10	1.5%	0.1%	10.1%	15.1%	29.2%	7.8%	20.7%
Annualized Return	4.4%	5.6%	8.7%	10.0%	11.4%	9.4%	15.2%
Annualized Standard Deviation	1.3%	0.9%	10.8%	15.7%	23.5%	17.3%	18.3%
Total Return (%)	483.6%	818.6%	2949.4%	4861.4%	8189.4%	3945.7%	32858.8%
Growth of $1	$5.84	$9.19	$30.49	$49.61	$82.89	$40.46	$329.59

Annualized Return is a compound set of returns expressed as a yearly return. • Total Return computes a simple aggregate return. • Growth of a Dollar computes the ending value of a dollar invested on the first day of the time period. • Standard Deviation measures the amount of variation in returns.

PLEASE READ THE IMPORTANT NOTICE STARTING ON PAGE 29.

January 1, 1970–December 31, 2010: FIVE-YEAR PERIODS

5 Years Ending	Inflation	T-Bills	T-Bonds	S&P 500 Index	Small Co. Stocks	EAFE Index	Int'l Small Co. Stocks
Dec-74	6.6%	5.9%	6.7%	-2.4%	-16.0%	0.4%	11.4%
Dec-75	6.9%	5.8%	6.2%	3.2%	-2.9%	9.4%	20.6%
Dec-76	7.2%	5.9%	6.8%	4.9%	2.4%	4.4%	11.1%
Dec-77	7.9%	6.2%	5.5%	-0.2%	6.8%	1.4%	12.4%
Dec-78	7.9%	6.2%	5.5%	4.3%	23.5%	10.8%	28.0%
Dec-79	8.2%	6.7%	4.3%	14.8%	41.3%	17.9%	36.7%
Dec-80	9.2%	7.8%	1.7%	13.9%	34.6%	15.6%	34.0%
Dec-81	10.1%	9.7%	-1.0%	8.1%	25.6%	14.5%	31.1%
Dec-82	9.5%	10.8%	6.0%	14.0%	26.7%	10.3%	17.4%
Dec-83	8.4%	11.1%	6.4%	17.3%	29.0%	8.8%	12.9%
Dec-84	6.6%	11.0%	9.8%	14.8%	16.4%	9.3%	15.6%
Dec-85	4.9%	10.3%	16.8%	14.7%	15.3%	14.7%	20.6%
Dec-86	3.3%	8.6%	21.6%	19.9%	14.2%	28.1%	32.4%
Dec-87	3.4%	7.6%	13.0%	16.5%	5.6%	34.4%	41.7%
Dec-88	3.5%	7.1%	15.0%	15.4%	3.7%	35.3%	39.5%
Dec-89	3.7%	6.8%	15.5%	20.4%	8.5%	36.1%	44.0%
Dec-90	4.1%	6.8%	10.7%	13.2%	-3.2%	18.0%	24.8%
Dec-91	4.5%	6.7%	9.8%	15.4%	4.4%	8.7%	15.0%
Dec-92	4.2%	6.3%	12.4%	15.9%	13.0%	1.3%	2.6%
Dec-93	3.9%	5.6%	14.1%	14.5%	12.6%	2.0%	3.9%
Dec-94	3.5%	4.7%	8.6%	8.7%	10.2%	1.5%	1.2%
Dec-95	2.8%	4.3%	13.4%	16.6%	24.4%	9.4%	5.5%
Dec-96	2.9%	4.2%	9.3%	15.2%	18.8%	8.2%	4.9%
Dec-97	2.6%	4.6%	10.5%	20.3%	18.0%	11.4%	6.5%
Dec-98	2.4%	5.0%	9.5%	24.1%	11.9%	9.2%	2.3%
Dec-99	2.4%	5.1%	9.2%	28.6%	18.9%	12.8%	4.9%
Dec-00	2.5%	5.2%	7.5%	18.3%	9.1%	7.1%	2.0%
Dec-01	2.2%	4.9%	8.5%	10.7%	11.6%	0.9%	-2.2%
Dec-02	2.3%	4.2%	8.8%	-0.6%	3.8%	-2.9%	0.4%
Dec-03	2.4%	3.4%	6.5%	-0.6%	18.5%	-0.1%	8.2%
Dec-04	2.5%	2.7%	10.3%	-2.3%	15.7%	-1.1%	8.5%
Dec-05	2.5%	2.1%	7.7%	0.5%	19.9%	4.6%	16.0%
Dec-06	2.7%	2.3%	7.2%	6.2%	17.0%	15.0%	26.1%
Dec-07	3.0%	2.9%	5.7%	12.8%	18.6%	21.6%	28.8%
Dec-08	2.7%	3.1%	10.3%	-2.2%	-5.1%	1.7%	3.2%
Dec-09	2.6%	2.8%	5.1%	0.4%	1.2%	3.5%	5.1%
Dec-10	2.2%	2.3%	5.6%	2.3%	5.7%	2.5%	4.8%
Annualized Return	4.4%	5.6%	8.7%	10.0%	11.4%	9.4%	15.2%
Annualized Standard Deviation	1.3%	0.9%	10.8%	15.7%	23.5%	17.3%	18.3%
Total Return (%)	483.6%	818.6%	2949.4%	4861.4%	8189.4%	3945.7%	32858.8%
Growth of $1	$5.84	$9.19	$30.49	$49.61	$82.89	$40.46	$329.59

Annualized Return is a compound set of returns expressed as a yearly return. • Total Return computes a simple aggregate return. • Growth of a Dollar computes the ending value of a dollar invested on the first day of the time period. • Standard Deviation measures the amount of variation in returns.

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Hypothetical Portfolio Returns Before Fees

January 1, 1995–December 31, 2010: SINGLE-YEAR PERIODS

1 Year Ending	Global Fixed Portfolio	Global Conservative Portfolio	Global Moderate Portfolio	Global Normal Portfolio	Global Aggressive Portfolio	Global Equity Portfolio
Dec-95	11.15%	13.57%	16.02%	18.50%	21.01%	23.54%
Dec-96	7.50%	9.62%	11.75%	13.88%	16.03%	18.17%
Dec-97	6.64%	8.11%	9.54%	10.92%	12.26%	13.55%
Dec-98	6.48%	6.96%	7.25%	7.33%	7.19%	6.84%
Dec-99	4.17%	7.24%	10.34%	13.45%	16.58%	19.72%
Dec-00	6.65%	5.41%	4.12%	2.81%	1.47%	0.09%
Dec-01	6.20%	5.52%	4.69%	3.74%	2.65%	1.43%
Dec-02	7.80%	4.35%	0.85%	-2.67%	-6.21%	-9.77%
Dec-03	2.32%	10.09%	18.33%	27.05%	36.27%	46.03%
Dec-04	1.83%	5.80%	9.86%	14.04%	18.31%	22.68%
Dec-05	1.67%	3.77%	5.86%	7.95%	10.03%	12.12%
Dec-06	4.41%	8.14%	11.96%	15.86%	19.85%	23.92%
Dec-07	5.16%	4.57%	3.94%	3.26%	2.53%	1.76%
Dec-08	5.12%	-5.39%	-15.20%	-24.33%	-32.81%	-40.66%
Dec-09	2.42%	9.42%	16.47%	23.55%	30.58%	37.53%
Dec-10	3.16%	7.11%	10.99%	14.79%	18.50%	22.10%
Annualized Return	5.14%	6.44%	7.63%	8.70%	9.64%	10.45%
Annualized Standard Deviation	1.77%	3.52%	6.75%	10.14%	13.57%	17.02%
Total Return (%)	122.92%	171.55%	224.36%	279.92%	336.04%	390.21%
Growth of $1	$2.23	$2.72	$3.24	$3.80	$4.36	$4.90

See page 30 for allocation information. • Annualized return is a compound set of returns expressed as a yearly return. • Total return computes a simple aggregate return. • Growth of a dollar computes the ending value of a dollar invested on the first day of the time period. • Standard deviation measures the amount of variation in returns. • The indices are not available for direct investment; therefore their performance does not reflect the expenses associated with the management of an actual portfolio.

PLEASE READ THE IMPORTANT NOTICE STARTING ON PAGE 29.

January 1, 1995–December 31, 2010: FIVE-YEAR PERIODS.

5 Years Ending	Global Fixed Portfolio	Global Conservative Portfolio	Global Moderate Portfolio	Global Normal Portfolio	Global Aggressive Portfolio	Global Equity Portfolio
Dec-99	7.16%	9.07%	10.94%	12.76%	14.52%	16.22%
Dec-00	6.28%	7.46%	8.57%	9.60%	10.55%	11.43%
Dec-01	6.02%	6.64%	7.16%	7.57%	7.88%	8.07%
Dec-02	6.25%	5.89%	5.40%	4.80%	4.07%	3.22%
Dec-03	5.41%	6.50%	7.50%	8.39%	9.19%	9.87%
Dec-04	4.93%	6.21%	7.40%	8.50%	9.51%	10.41%
Dec-05	3.93%	5.88%	7.76%	9.57%	11.30%	12.95%
Dec-06	3.58%	6.40%	9.22%	12.02%	14.80%	17.56%
Dec-07	3.07%	6.45%	9.88%	13.35%	16.87%	20.43%
Dec-08	3.63%	3.27%	2.79%	2.19%	1.45%	0.58%
Dec-09	3.74%	3.97%	4.00%	3.84%	3.48%	2.91%
Dec-10	4.05%	4.63%	4.99%	5.13%	5.02%	4.68%
Annualized Return	5.14%	6.44%	7.63%	8.70%	9.64%	10.45%
Annualized Standard Deviation	1.77%	3.52%	6.75%	10.14%	13.57%	17.02%
Total Return (%)	122.92%	171.55%	224.36%	279.92%	336.04%	390.21%
Growth of $1	$2.23	$2.72	$3.24	$3.80	$4.36	$4.90

See page 30 for allocation information. • Annualized return is a compound set of returns expressed as a yearly return. • Total return computes a simple aggregate return. • Growth of a dollar computes the ending value of a dollar invested on the first day of the time period. • Standard deviation measures the amount of variation in returns. • The indices are not available for direct investment; therefore their performance does not reflect the expenses associated with the management of an actual portfolio.

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APPENDIX

Important Notice

Comparative Index Returns Data (One- and Five-Year Periods)

- Standard deviation: Annualized number based on monthly data. Annualized number is presented as an approximation by multiplying the monthly number by the square root of the number of periods in a year. Please note that the number computed from annual data may differ materially from this estimate.
- Median of five-year rolling returns: Frequency is monthly. Overlapping returns = 60 months, annualized.
- Standard deviation of five-year rolling returns: Frequency is monthly. Overlapping returns = 60 months, annualized.
- Median of ten-year rolling returns: Frequency is monthly. Overlapping returns = 120 months, annualized.
- Standard deviation of ten-year rolling returns: Frequency is monthly. Overlapping returns = 120 months, annualized.
- Inflation = U.S. Consumer Price Index.
- T-Bills = One-Month Treasury Bill Index.
- T-Bonds = Long-Term Government Bonds Index.
- Small Company Stocks = CRSP 9–10 Index.
- International Small Company Stocks = Dimensional International Small Index.
- EAFE Index = EAFE Net Index.

Hypothetical Portfolio Returns Before Fees (One- and Five-Year Periods)

The Global Fixed, Global Conservative, Global Moderate, Global Normal, Global Aggressive and Global Equity hypothetical portfolios illustrate how an asset allocation strategy could have performed in those markets. Results presented are hypothetical and are provided to educate investors on the performance of different asset classes over an extended period of time. The results are not intended to represent the performance of a particular investment.

Our hypothetical portfolios hold percentages constant by rebalancing the portfolios at the beginning of each calendar month. No management fees, advisory fees and/or transaction costs were deducted. Past performance is not indicative of future performance. This is especially the case with a hypothetical portfolio, which is not subject to specific economic and market conditions.

All investments involve risk, including loss of principal. Foreign securities involve additional risks, including foreign currency changes, political risks, foreign taxes, and different methods of accounting and financial reporting. Treasury bills and government bonds are guaranteed as to repayment of principal and interest by the U.S. government. The S&P 500 Index is an unmanaged stock index, with dividends reinvested, that is generally considered representative of the large U.S. equity market.

- Standard deviation: Annualized number based on monthly data. Annualized number is presented as an approximation by multiplying the monthly number by the square root of the number of periods in a year. Please note that the number computed from annual data may differ materially from this estimate.
- Median of five-year rolling returns: Frequency is monthly. Overlapping returns = 60 months, annualized.
- Standard deviation of five-year rolling returns: Frequency is monthly. Overlapping returns = 60 months, annualized.

Global Portfolio Allocations

	Global Fixed Portfolio	Global Conservative Portfolio	Global Moderate Portfolio	Global Normal Portfolio	Global Aggressive Portfolio	Global Equity Portfolio
Equity	**0.0%**	**20.0%**	**40.0%**	**60.0%**	**80.0%**	**100.0%**
U.S. Stocks	**0.0%**	**14.0%**	**28.0%**	**42.0%**	**56.0%**	**70.0%**
Large Cap Market Enhanced U.S. Large Company Portfolio	0.0	4.0	8.0	12.0	16.0	20.0
Large Cap Value U.S. Large Cap Value Portfolio	0.0	4.0	8.0	12.0	16.0	20.0
Small Cap Market U.S. Micro Cap Portfolio	0.0	2.0	4.0	6.0	8.0	10.0
Small Cap Value U.S. Small Cap Value Portfolio	0.0	2.0	4.0	6.0	8.0	10.0
Real Estate Stocks Real Estate Securities Portfolio	0.0	2.0	4.0	6.0	8.0	10.0
International Stocks	**0.0%**	**6.0%**	**12.0%**	**18.0%**	**24.0%**	**30.0%**
International Large Cap Value International Value Portfolio	0.0	2.0	4.0	6.0	8.0	10.0
International Small Cap Market International Small Company Portfolio	0.0	1.0	2.0	3.0	4.0	5.0
International Small Cap Value International Small Cap Value Portfolio	0.0	1.0	2.0	3.0	4.0	5.0
Emerging Markets Large Emerging Markets Portfolio	0.0	0.6	1.2	1.8	2.4	3.0
Emerging Markets Value Emerging Markets Value Portfolio	0.0	0.6	1.2	1.8	2.4	3.0
Emerging Markets Small Emerging Markets Small Cap Portfolio	0.0	0.8	1.6	2.4	3.2	4.0
Fixed Income	**100.0%**	**80.0%**	**60.0%**	**40.0%**	**20.0%**	**0.0%**
One-Year Fixed Income Portfolio	25.0	20.0	15.0	10.0	5.0	0.0
Two-Year Global Fixed Income Portfolio	25.0	20.0	15.0	10.0	5.0	0.0
Five-Year Government Portfolio	25.0	20.0	15.0	10.0	5.0	0.0
Five-Year Global Fixed Income Portfolio	25.0	20.0	15.0	10.0	5.0	0.0

For illustrative purposes only. Data series consist of live returns. They do not reflect the deduction of advisory fees, brokerage fees and other expenses incurred by the portfolios, and incorporate actual trading results. For portfolio construction prior to April 1998, live funds are linked in order to extend the data series to 1995. The portfolio construction methodology for that time period is outlined below:

1. Enhanced U.S. Large Cap Strategy weighting allocated to U.S. Large Cap Strategy prior to April 1996.
2. Emerging Markets Value Strategy weighting allocated equally to Emerging Markets Strategy and Emerging Markets Small Cap Strategy prior to April 1998.
3. Emerging Markets Small Cap Strategy weighting allocated to Emerging Markets Strategy prior to March 1998.
4. International Small Cap Strategy weighting allocated to 35 percent Japan Small Cap Strategy, 35 percent Continental Small Cap Strategy, 15 percent U.K. Small Cap Strategy and 15 percent Pacific Rim Small Cap Strategy prior to August October 1996.
5. Two-Year Global Fixed Income Strategy weighting allocated equally to One-Year Fixed Income Strategy, Five-Year Government Strategy and Five-Year Global Fixed Income Strategy prior to March 1996.

Global Index Portfolio Allocations

	Normal Balanced Indexed Strategy
Equity	**60.0%**
U.S. Stocks	**42.0%**
Large Cap Market S&P 500 Index	12.0
Large Cap Value Fama/French U.S. Large Value Index (ex utilities)	12.0
Small Cap Market Fama/French U.S. Small Cap Index	6.0
Small Cap Value Fama/French U.S. Small Cap Value Index (ex utilities)	6.0
Real Estate Stocks Dow Jones Wilshire REIT Index	6.0
International Stocks	**18.0%**
International Large Cap Value MSCI EAFE Value Index	6.0
International Small Cap Dimensional Intl. Small Cap Index	3.0
International Small Cap Value Dimensional Intl. Small Cap Value Index	3.0
Emerging Markets Large MSCI Emerging Markets Index (Gross)	1.8
Emerging Markets Value Fama/French Emerging Markets Value Index	1.8
Emerging Markets Small Fama/French Emerging Markets Small Cap Index	2.4
Fixed Income	**40.0%**
One-Year US Fixed Income Merrill Lynch One-Year US Treasury Note Index	10.0
Two-Year Global Fixed Income Citigroup World Government Bond Index 1-3 Years (Hedged, USD)	10.0
Five-Year Government Lehman Brothers Treasury Bond Index 1-5 Years	10.0
Five-Year Global Fixed Income Citigroup World Government Bond Index 1-5 Years (Hedged, USD)	10.0

For illustrative purposes only. Data series consist of index returns. The indices are not available for direct investment; therefore their performance does not reflect the expenses associated with the management of an actual portfolio. For portfolio construction prior to January 1989, indexes are linked in order to extend the data series to 1973. The portfolio construction methodology is outlined below:

1. Real Estate Stocks allocation weighting allocated equally to Small Cap and Small Value prior to January 1978.
2. International Small Value allocation weighting to International Small Cap prior to July 1981.
3. International Large Cap Value allocation weighting allocated equally to International Small Cap and MSCI EAFE Index prior to January 1975.
4. Emerging Markets Large allocation weighting allocated equally to International Small Cap and International Large Cap Value prior to January 1988.
5. Emerging Markets Value allocation weighting allocated equally to International Small Cap and International Large Cap Value prior to January 1989.
6. Emerging Markets Small allocation weighting allocated equally to International Small Cap and International Large Cap Value prior to January 1989.
7. Five-Year Global Fixed Income allocation weighting allocated to Lehman Brothers Intermediate US Government Bond Index prior to January 1990.

8. Two-Year Global Fixed Income allocation weighting allocated to Merrill Lynch One-Year US Treasury Note Index prior to January 1990.
9. Five-Year US Government Fixed Income allocation weighting allocated to Lehman Brothers Intermediate US Government Bond Index prior to January 1976.

Sources and Description of Data

All Dimensional portfolio returns are net of all fees unless otherwise indicated. All Dimensional trust returns are net of administrative fees only unless otherwise indicated. Prior to April 2002, certain international equity portfolios charged a reimbursement fee to the purchasers of shares of those portfolios.

Performance data shown represents past performance. Past performance is no guarantee of future results and current performance may be higher or lower than the performance shown. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. To obtain performance data current to the most recent month-end access our website at www.dimensional.com. Average annual total returns include reinvestment of dividends and capital gains. DFA is an investment advisor registered with the SEC. Consider the investment objectives, risks, and charges and expenses of the Dimensional funds carefully before investing. For this and other information about the Dimensional funds, please read the prospectus carefully before investing. Prospectuses are available by calling Dimensional Fund Advisors collect at (310) 395-8005; on the Internet at www.dimensional.com; or, by mail, DFA Securities Inc., c/o Dimensional Fund Advisors, 1299 Ocean Avenue, Santa Monica, CA 90401. Mutual funds distributed by DFA Securities Inc.

Prior to April 1, 2002, the following reimbursement fees may have been charged to purchasers of the respective portfolios: International Small Company Portfolio 0.675%; Continental Small Company Portfolio 1.00%; Japanese Small Company Portfolio 0.50%; Pacific Rim Small Company Portfolio 1.00%; International Small Cap Value Portfolio 0.675%; Emerging Markets Small Cap Portfolio 1.00%; Emerging Markets Value Portfolio 0.50%; Emerging Markets Portfolio 0.50%. Prior to April 1998, the reimbursement fee for the International Small Company Portfolio was 0.70% and the reimbursement fee for the International Small Cap Value Portfolio was 0.70%. Prior to July 1995, the reimbursement fees were as follows: International Small Cap Value Portfolio 1.00%; Continental Small Company Portfolio 1.50%; Japanese Small Company Portfolio 1.00%; Pacific Rim Small Company Portfolio 1.50%; UK Small Company Portfolio 1.50%; Emerging Markets Portfolio 1.50%. Returns for these portfolios are presented net of these reimbursement fees.

All reimbursement fees are based on the net asset value of the shares purchased. The standardized returns presented reflect deduction, where applicable, of the reimbursement fees for the portfolios. Non-standardized performance data reported by Dimensional Fund Advisors Inc. does not reflect deduction of the reimbursement fee. If reflected, the fee would reduce the performance quoted.

Principal Risks The principal risks of investing in the Dimensional funds may include one or more of the following: market risk, small companies risk, risk of concentrating in the real estate industry, foreign securities and currencies risk, emerging markets risk, banking concentration risk, interest rate risk, risk of investing for inflation protection, risk of municipal securities, and/or fund of funds risk. To more fully understand the risks related to an investment in the funds, investors should carefully read each fund's prospectus.

Investments in foreign issuers are subject to certain considerations that are not associated with investments in US public companies. Investments of the International Equity, Emerging Markets Equity and the Global Fixed Income Portfolios will be denominated in foreign currencies. Changes in the relative values of these foreign currencies and the US dollar, therefore, will affect the value of investments in the Portfolios. However, the Global Fixed Income Portfolios will utilize forward currency contracts to minimize these changes. Further, foreign issuers are not generally subject to uniform accounting, auditing, and financial reporting standards comparable to those of US public corporations and there may be less publicly available information about such companies than comparable US companies. Also, legal, political, or diplomatic actions of foreign governments, including expropriation, confiscatory taxation, and limitations on the removal of securities, property, or other assets of the Portfolios, could adversely affect the value of the assets of these Portfolios.

Securities of small companies are often less liquid than those of large companies. As a result, small company stock and the funds which invest in them may fluctuate relatively more in price. Although securities of larger firms fluctuate relatively less, economic, political and issuer specific events will cause the value of all securities and the funds which invest in them to fluctuate as well.

Additionally:

DFA Real Estate Securities Portfolio is concentrated in the real estate industry. The Portfolio's exclusive focus on the real estate industry may cause its risk to approximate the general risks of direct real estate ownership. Its performance may be materially different from the broad US equity market.

Fixed Income Portfolios:

The net asset value of a fund that invests in fixed income securities will fluctuate when interest rates rise. An investor can lose principal value investing in a fixed income fund during a rising interest rate environment.

Risk of Banking Concentration

Focus on the banking industry would link the performance of the DFA One-Year Fixed Income and/or the Two-Year Global Fixed Income Portfolios to changes in performance of the banking industry generally. For example, a change in the market's perception of the riskiness of banks compared to non-banks would cause the Portfolio's values to fluctuate.

Inflation Protected Securities Portfolio: Inflation –protected securities are expected to be protected from long-term inflationary trends, short-term increases in inflation may lead to a decline in the Portfolio’s value. If interest rates rise due to reasons other than inflation, the Portfolio’s investment in these securities may not be protected to the extent that the increase is not reflected in the securities’ inflation measures. The Portfolio may also suffer a loss during periods of sustained deflation.

Short Term Muni Bond Portfolio: Municipal Bonds may be subject to income risk, which is the risk that falling interest rates will cause the Portfolio's income to decline, and interest rate risk, which is the risk that bond prices overall will decline over short or even long periods because of rising interest rates. The Portfolio may also be affected by: call risk, which is the risk that during periods of falling interest rates, a bond issuer will call or repay a higher-yielding bond before its maturity date; credit risk, which is the risk that a bond issuer will fail to pay interest and principal in a timely manner; and tax liability risk, which is the risk of noncompliant conduct by a bond issuer, resulting in distributions by the Portfolio being taxable to share-holders as ordinary income. Finally, there is legislative or regulatory risk, which is the risk that new federal or state legislation may adversely affect the tax-exempt status of securities held by the Portfolio, or that there could be an adverse interpretation by the Internal Revenue Service or by state tax authorities.

Global Equity, Global 60/40, Global 25/75 Portfolios:

Fund of Funds Risk

The investment performance of each Portfolio is affected by the investment performance of the Underlying Funds in which the Portfolio invests. The ability of a Portfolio to achieve its investment objective depends on the ability of the Underlying Funds to meet their investment objectives and on the Advisor's decisions regarding the allocation of the Portfolio's assets among the Underlying Funds. There can be no assurance that the investment objective of any Portfolio or Underlying Fund will be achieved. Through their investments in the Underlying Funds, the Portfolios are subject to the risks of the Underlying Funds investments. The risks of the Underlying Funds may include Market Risk, Small Company Risk, Risks of Concentrating in the Real Estate Industry, Emerging Markets Risk, Interest Rate Risk, Credit Risk, and Risks of Banking Concentration

Definitions of Statistical Terms

Average Returns (arithmetic mean) is a measure of the "middle performance" of the fund, computed by adding up all the returns and dividing by the number of periods.

Standard Deviation measures how different the actual fund returns are from its average performance (see above). The closer the actual returns are to the average, the smaller the standard deviation. Standard deviation is a measure of volatility, generally associated with the risk of investments.

Correlation measures the degree to which the performance of two funds moves in tandem, and the direction of their association (one goes up, the other goes up as well – positive correlation). Correlation plays an important part in diversification.

Turnover is a measure of the fund's trading activity, and loosely represents the portion of a fund's holdings that have changed over a year. A lower turnover ratio indicates a more passive strategy.

Tracking Error shows how different are each period's returns of a given fund from the returns of a reference "benchmark" (generally commercial indexes). For example, if fund A's returns in two subsequent periods are 10% and 20%, while the benchmark's returns are 5% and 25% for the same periods, the average is the same (15%), but there is tracking error since there was a difference in period by period returns (period 1: 10% versus 5%, period 2: 20% versus 25%).

U.S. Small

- **Russell 2000 Index.** 1979–present: Courtesy of Russell Analytic Services. Comprised of the 2000 smallest companies in the Russell 3000 Index, which is comprised of the largest 3000 U.S. companies based on market capitalization.
- **Russell 2000 Growth Index.** 1979–present: Courtesy of Russell Analytic Services. Comprised of the Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values.
- **Russell 3000 Growth Index.** 1979–present: Courtesy of Russell Analytic Services. Comprised of the Russell 3000 companies with higher price-to-book ratios and higher forecasted growth values.
- **CRSP 9–10 Index.** 1926–present: Courtesy of CRSP.[22] Deciles 9–10 NYSE[23] (plus AMEX[24] equivalents since July 1962 and NASDAQ[25] equivalents since 1973).
- **CRSP 6–10 Index.** 1926–present: Courtesy of CRSP. Deciles 6–10 NYSE (plus AMEX equivalents since July 1962 and NASDAQ equivalents since 1973).
- **CRSP 6–7–8 Index.** 1926–present: Courtesy of CRSP. Deciles 6–7–8 NYSE (plus AMEX equivalents since July 1962 and NASDAQ equivalents since 1973).
- **Fama/French U.S. Small Cap Growth Simulated Strategy.** July 1963–present: Courtesy of Fama/French[26] and CRSP. Simulated strategy of lower-half market cap, lower 30 percent book-to-market NYSE (plus AMEX equivalents since July 1962 and NASDAQ equivalents since 1973). Includes estimated hold range and trading costs since July 1963, rebalanced quarterly.

U.S. Value

- **Russell 2000 Value Index.** 1979–present: Courtesy of Russell Analytic Services. Comprised of the Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values.
- **Russell 3000 Value Index.** 1979–present: Courtesy of Russell Analytic Services. Comprised of the Russell 3000 companies with lower price-to-book ratios and lower forecasted growth values.
- **Fama/French U.S. Small Cap Value Simulated Strategy.** July 1963–present: Courtesy of Fama/French and CRSP. Simulated strategy of lower-half market cap, upper 30 percent book-to-

[22] CRSP: Center for Research in Security Prices, University of Chicago.
[23] NYSE: New York Stock Exchange.
[24] AMEX: American Stock Exchange.
[25] NASDAQ: NASDAQ National Market System.
[26] Fama/French: Professor Eugene F. Fama, Graduate School of Business, University of Chicago and Kenneth R. French, Tuck School of Business Administration, Dartmouth College.

market NYSE (plus AMEX equivalents since July 1962 and NASDAQ equivalents since 1973). Includes estimated hold range and trading costs since July 1963, rebalanced quarterly.

- **Fama/French U.S. Small Cap Value Index.** July 1963–present: Courtesy of Fama/French and CRSP. Lower-half market cap, upper 30 percent book-to-market. Buy range-only, no simulated hold range or estimated trading costs, rebalanced quarterly.
- **Wilshire Small Value Index.** 1978–present: Courtesy of Wilshire Associates Inc. Market cap weighted index of value securities from Wilshire Small Cap 1750 Index.
- **Fama/French U.S. 4–10 Value Simulated Strategy.** July 1963–present: Courtesy of Fama/French and CRSP. Simulated strategy of lower 70 percent market cap, upper 30 percent book-to-market NYSE (plus AMEX equivalents since July 1962 and NASDAQ equivalents since 1973). Includes estimated hold range and trading costs since July 1963, rebalanced quarterly.
- **Russell 1000 Value Index.** 1979–present: Courtesy of Russell Analytic Services. Comprised of Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.
- **Fama/French U.S. Large Cap Value Simulated Strategy.** July 1963–present: Courtesy of Fama/French and CRSP. Simulated strategy of upper-half market cap, upper 30 percent book-to-market NYSE (plus AMEX equivalents since July 1962 and NASDAQ equivalents since 1973). Includes estimated hold range and trading costs since July 1963, rebalanced quarterly.
- **Fama/French U.S. Large Cap Value Index.** July 1963–present: Courtesy of Fama/French and CRSP. Upper-half market cap, upper 30 percent book-to-market. Buy range-only, no simulated hold range or estimated trading costs, rebalanced quarterly.
- **Wilshire Large Value Index.** 1978–present: Courtesy of Wilshire Associates Inc. Market cap weighted index of value securities from Wilshire Large Cap 750 Index.

U.S. Large

- **S&P 500 Index.** 1926–present: Courtesy of *Stocks, Bonds, Bills, and Inflation*, Ibbotson Associates, Chicago (annually updates work by Roger G. Ibbotson and Rex A. Sinquefield). Used with permission. All rights reserved. Comprised of the largest 500 U.S. companies based on market capitalization.
- **Wilshire 5000 Index.** 1978–present: Courtesy of Wilshire Associates Inc. Broad market Index, measures entire U.S. stock market.
- **Russell 1000 Index.** 1979–present: Courtesy of Russell Analytic Services. Comprised of the 1,000 largest companies in the Russell 3000 Index.
- **Russell 1000 Growth Index.** 1979–present: Courtesy of Russell Analytic Services. Comprised of Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.
- **Fama/French U.S. Large Cap Growth Simulated Strategy.** July 1963–present: Courtesy of Fama/French and CRSP. Simulated strategy of upper-half market cap, lowest 30 percent book-to-market NYSE (plus AMEX equivalents since July 1962 and NASDAQ equivalents since 1973). Includes estimated hold range and trading costs since July 1963 for growth stocks designed to mirror Dimensional's Value Strategies, rebalanced quarterly.
- **Fama/French U.S. Large Cap Growth Index.** July 1963–present: Courtesy of Fama/French and CRSP. Upper-half market cap, lower 30 percent book-to-market. Buy range-only, no simulated hold range or estimated trading costs, rebalanced quarterly.
- **Wilshire REIT Index.** 1975–present: Courtesy of Wilshire Associates Inc.

International Small

- **MSCI EAFE Small Cap Index.** 1993–present: Courtesy of Morgan Stanley Capital International. Europe, Australasia and Far East Small Cap Index.
- **S&P/Citigroup Extended Market Index.** July 1989–present: Courtesy of Citigroup Global Equity Index System. EPAC Extended Market Index.

International Value

- **MSCI EAFE Value/Growth Index.** 1975–present: Courtesy of Morgan Stanley Capital International. Europe, Australasia and Far East Value/Growth Index. Covers 20 developed markets. Price/Book Value (p/BV) ratios divide standard MSCI country indices into value (low p/BV) or growth (high p/BV), relative to each MSCI country index. Country Value/Growth

indices are aggregated into regional Value/Growth indices, net dividends and returns in U.S. dollars.

International Large

- **MSCI EAFE Index.** 1970–present: Courtesy of Morgan Stanley Capital International. Europe, Australasia and Far East Index net dividends.
- **United Kingdom Large Company Index.** February 1955–present: Courtesy of Financial Times-Actuaries. Financial Times-Actuaries All Share Index.
- **Continental Large Company Index.** 1970–present: Courtesy of Morgan Stanley Capital International. MSCI Europe excluding United Kingdom Index, gross dividends reinvested (in U.S. dollars).
- **Japanese Large Company Index.** 1970–June 1986: Courtesy of the Nomura Securities Investment Trust Management Company, Ltd., Tokyo. Larger half of first section, Tokyo Stock Exchange. July 1986–present: Courtesy of Morgan Stanley Capital International. MSCI Japan Index.
- **Pacific Rim Large Company Index.** 1970–present: Courtesy of Morgan Stanley Capital International. MSCI Pacific Rim, excluding Japan Index, gross dividends reinvested (in U.S. dollars).

Emerging Markets

- **MSCI Emerging Markets Index.** 1993–present: Courtesy of Morgan Stanley Capital International. Composed of 28 countries designated as emerging by MSCI. Gross of all fees.

Fixed Income

- **One Month Certificate of Deposit.** 1947–October 1971: One-Month Bankers' Acceptances. November 1972–present: One-Month Certificates of Deposit.
- **Rolling Three-Month Treasury Bills.** 1978–present: Courtesy of Merrill Lynch.
- **Rolling Six-Month Treasury Bills.** 1964–December 1977: Courtesy of CRSP. 1978–present: Courtesy of Merrill Lynch.
- **Rolling One-Year Treasury Bills.** July 1963–May 1991: Courtesy of CRSP/DFA. Rolling One-Year Treasury Bills Returns. Buy at 12 months, sell at 11 months. June 1991–present: Courtesy of Merrill Lynch.
- **Thirty-Day Treasury Bills.** 1926–present: Courtesy of *Stocks, Bonds, Bills, and Inflation*, Ibbotson Associates, Chicago (annually updates work by Roger G. Ibbotson and Rex A. Sinquefield). Used with permission. All rights reserved.
- **Five-Year Treasury Notes.** 1926–present: Courtesy of *Stocks, Bonds, Bills, and Inflation*, Ibbotson Associates, Chicago (annually updates work by Roger G. Ibbotson and Rex A. Sinquefield). Used with permission. All rights reserved.
- **Long-Term Corporate Bond Returns.** 1926–present: Courtesy of *Stocks, Bonds, Bills, and Inflation*, Ibbotson Associates, Chicago (annually updates work by Roger G. Ibbotson and Rex A. Sinquefield). Used with permission. All rights reserved. Average maturity: 20 years.
- **Long-Term Treasury Bonds.** 1926–present: Courtesy of *Stocks, Bonds, Bills, and Inflation*, Ibbotson Associates, Chicago (annually updates work by Roger G. Ibbotson and Rex A. Sinquefield). Used with permission. All rights reserved. Average maturity: 20 years.
- **Lipper Institutional Money Market Index.** 1975–December 1983: Courtesy of Lipper. Lipper Money Market Fund Index monthly returns. 1984–present: Lipper Institutional Money Market Index monthly returns.
- **Merrill Lynch 1–3 Year Government Index.** July 1977–present: Courtesy of Merrill Lynch. U.S. Government. Maturities: 1 to 3 years.
- **Lehman Intermediate Government Index.** 1973–present Courtesy of Lehman Brothers Inc. Maturities: 1 to 10 years.
- **Lehman Intermediate Government/Credit Bond Index.** 1973–present: Courtesy of Lehman Brothers Inc. Maturities: 1 to 10 years.
- **Lehman Government/Credit Bond Index.** 1973–present: Courtesy of Lehman Brothers Inc. Maturities: 1 to 30+ years.

- **Lehman Aggregate Index.** 1976–present: Courtesy of Lehman Brothers Inc. Includes Lehman Government/Credit Bond Index, Mortgage-Backed and Asset-Backed Securities Indices. Maturities: 1 to 30+ years.
- **Lehman Government Index.** 1973–present: Courtesy of Lehman Brothers Inc. Maturities: 1 to 30 years.
- **Lehman Global Hedged Country Index.** 1985–present: Courtesy of Lehman Brothers Inc.
- **Lehman Global Unhedged Country Index.** 1985–present: Courtesy of Lehman Brothers Inc.
- **Lehman Municipal Bond Three-Year Index.** 1990–present: Courtesy of Lehman Brothers Inc.
- **Inflation**. Courtesy of *Stocks, Bonds, Bills, and Inflation*, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield). Used with permission. All rights reserved.
- **Citigroup 1–5 Year World Government Bond Index.** 1985–present: Courtesy of Citigroup. Maturities: 1 to 5 years.
- **Citigroup 1–30+ Year World Government Bond Index.** 1985–Present: Courtesy of Citigroup. Maturities: 1 to 30+ years.