Factors In Focus

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Sweating the Details

by Eric D. Nelson, CFA

I wake up every morning and the first thing I do is press start on my coffee bean grinder. The beans, Major Dickason's Blend, are from Peet's in Berkeley, CA. This coffee was first created in 1969 and the recipe was refined countless times until they arrived at today's best-selling blend. I have a pound of the beans shipped to me every week; they arrive supremely fresh—roasted and sent the following day. Fresh beans make the best coffee.

While grinding, I heat water in a teakettle to boiling, and then let it sit until it cools to about 205 degrees, considered the optimal temperature for coffee. Then I dump the grounds into the bonded paper cone filter of my Chemex coffee maker, after wetting it to remove the paper taste and to warm the glass carafe. After four pours of about 98g of water (390g total), each about one minute apart, carefully measured by a Hario scale that the Chemex sits on, my coffee is ready to pour and drink.

It's the best coffee I know how to make. I do it this way every time. I have the same set up in my office for a subsequent cup later in the morning.

You probably know you could have better coffee than the stuff that comes from your Keurig or that has been sitting in your drip pot for the last three hours baking on the hot plate. But you've decided that stuff is good enough. The thought of going to the lengths I describe for a cup of coffee sounds extreme. I don't disagree. But I love good coffee and for me, it's worth the effort. We are all willing to sweat the details, to go the extra mile for things that are really important.

Guess what else is really important to me, that I go to great lengths to make sure I get right? **The design and management of your investment portfolio**.

You Deserve the Best

I've spent thousands of hours reading academic financial research, investment books, studying historical returns, running statistical regressions, and modeling portfolios. I look at every reasonable investment option—low-cost actively managed funds, exchange-traded index funds, factor-based strategies, not to mention all of the alternative assets the mutual fund and ETF industries are constantly developing. One thing hasn't changed in the last 15 years—I can't find better strategies to invest your hard earned wealth than Dimensional Fund Advisors (DFA) mutual funds.

I'm not paid to say that, of course. Servo is a Registered Investment Advisor (RIA) and a fiduciary, not a broker. That means Servo only earns income that comes directly from the fees clients pay that are clearly explained upfront and invoiced every quarter. Servo isn't paid to sell products. Stocks, annuities, exchange-traded funds, Vanguard funds, DFA funds—Servo doesn't earn one penny more or less regardless of which investments I use. I am free to recommend only the investments I feel are the best in helping you to accomplish your long-term goals. *That's why I use DFA funds*.

All of my personal and business assets are in DFA funds; all of my parents' assets are in DFA funds and my brother and his wife are exclusively invested in DFA funds outside of their 401(k)s. Why would I recommend something

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different for the clients who have entrusted Servo with their lifetime savings?

For an advisor, this isn't always the easiest stance to take. From a marketing perspective, it would be easier to sprinkle in some Vanguard funds, some ETFs, and maybe a few stocks or individual bonds. I would look much more "judicious." But in every case I would be sacrificing some of your expected returns or taking added risk for the returns you're expected to get. Good marketing? *Maybe*. Good for your wealth? *Nope*.

Some prospective clients wonder how we can claim to be diversified when our assets are in one fund family. It requires me to explain, sometimes in vain, that diversification only pertains to the *securities we own*, not the *fund company that holds them* for us. At about 12,000 stocks in 40+ countries in a typical equity portfolio, we are about as diversified as possible.

Why DFA?

Indexes are hard to beat, like a Keurig is hard to beat for a pretty good quick cup of coffee. In fact, over the 20 years ending in 2018, only 15% of mutual funds outperformed their index benchmarks. But basic indexes, like a Keurig, can be improved upon. DFA reports that 85% of their funds have outperformed their index benchmarks over the same period of time, due to their greater emphasis on the sources of expected returns (small cap vs. large cap and low-priced "value" vs. high-priced "growth" stocks) and continuous management techniques.

But that's their data. When I independently verify those statistics, as I do with everything, I find the numbers only get better. If I look at the 11 stock asset class funds they manage that comprise the DFA Equity Balanced Strategy, 10 outperformed their index from 1999-2018, net of DFA fund expense ratios. Eight outperformed by more than 1% per year. The one that didn't trailed the S&P 500 by 0.08% per year.

I could drink Keurig coffee. The taste wouldn't measure up but I'd still get the caffeine. In managing your portfolio, I could use traditional index funds and ETFs, and maybe even a few actively managed funds. You would still accomplish many of your goals as long as I kept you disciplined. But better funds, that capture the stock market, small cap, and value premiums more consistently, offer you the potential for a better lifetime financial outcome: more wealth, more retirement income, and a larger financial legacy. Those things matter to you and they matter to me, too. ***I sweat the details***.

		1999-2018 Annualized Returns			
Asset Class	DFA Symbol	DFA Fund Return	Index	Index Return	DFA Advantage
US Large Cap (S&P 500)	DFELX	5.5%	S&P 500	5.6%	-0.1%
US Large Value	DFLVX	7.5%	Russell 1000 Value	6.2%	1.4%
US Small Cap	DFSCX	9.7%	Russell 2000	7.4%	2.3%
US Small Value	DFSVX	9.7%	Russell 2000 Value	8.2%	1.4%
Real Estate (REITs)	DFREX	10.0%	DJ Wilshire REIT	9.8%	0.1%
Int'l Large Value	DFIVX	5.4%	MSCI World ex-US Value	4.3%	1.1%
Int'l Small Cap	DFISX	8.3%	MSCI World ex-US Small Cap	7.2%	1.0%
Int'l Small Value	DISVX	9.1%	MSCI World ex-US Small Value	8.1%	1.0%
Emerging Mkts Large Cap	DFEMX	8.8%	MSCI Emerging Mkts	8.5%	0.3%
Emerging Mkts Value	DFEVX	10.8%	MSCI Emerging Mkts Value	8.8%	2.0%
Emerging Mkts Small Cap	DFEMX	11.3%	MSCI Emerging Mkts Small Cap	8.0%	3.3%

Contact Eric Nelson, CFA at eric@servowealth.com with any questions, comments, thoughts, or to discuss your personal financial situation.