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Dealing with Market Turbulence & Uncertainty

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"The farther one gets from Wall Street, the more skepticism one will find we believe, as to the pretensions of stock-market forecasting or timing. The investor can scarcely take seriously the innumerable predictions which appear almost daily and are his for the asking."

-Benjamin Graham

However, we will make a forecast for a wee addition (after contractions). In November, Derek and his wife, Tiffany, are anticipating the arrival of their first child, daughter, Sloane Elizabeth Johnson. We are eagerly looking forward to the new addition to the Johnson family.

The third quarter this year came with quite a bit of unpleasant turbulence. For the 15 days beginning August 20, the daily range between highs and lows exceeded 415 points on average[1]. This was the worst performing quarter in the domestic markets since 2011[2].

Index	Third Quarter Performance
S&P 500	-6.9%
STOXX Europe 500	-8.8%
MSCI Emerging Markets	-18.5%
Nikkei 225	-14.1%
Shanghai Composite	-28.6%[3]
DFA Global 60/40 Portfolio	-5.8%[4]

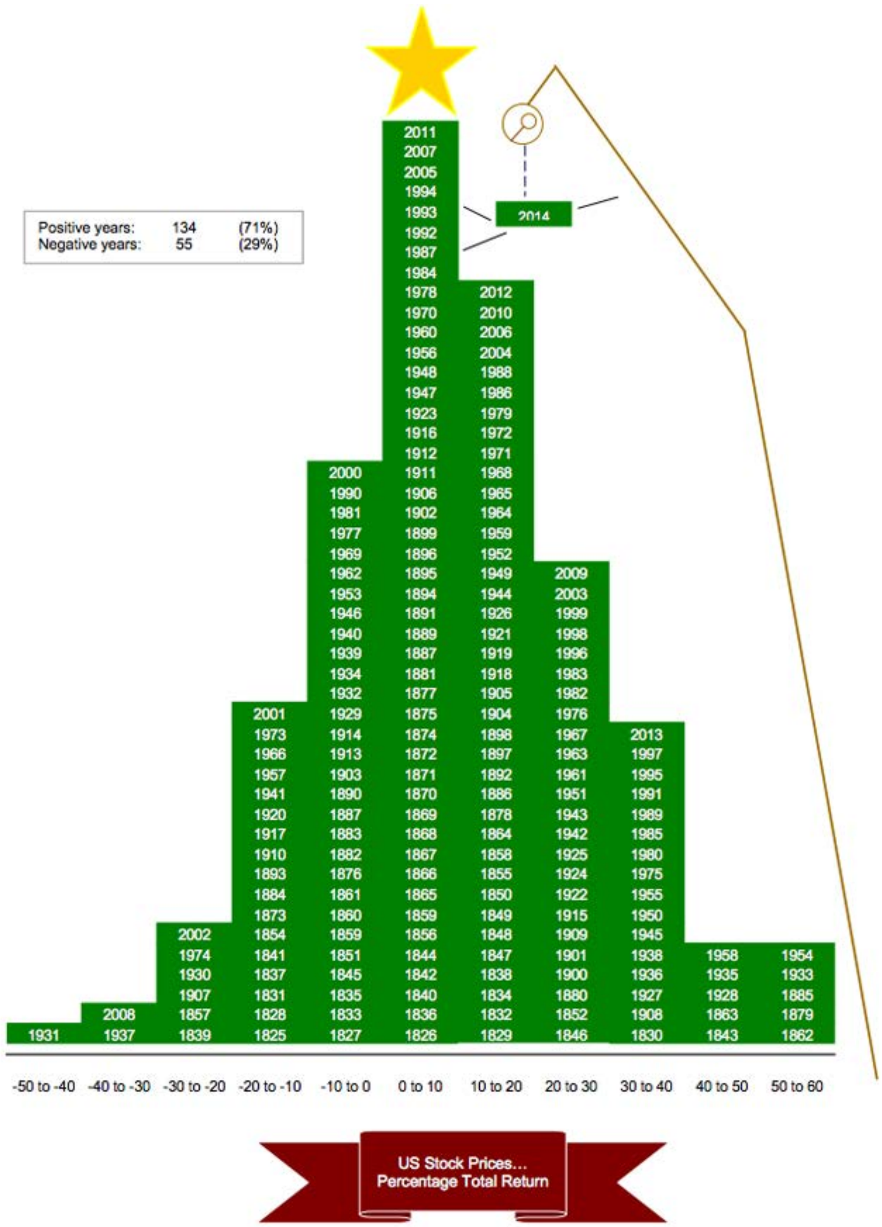
DFA Global 60/40 Portfolio performance provided as a courtesy for comparison purposes. The DFA Global 60/40 Portfolio is a balanced portfolio comprised of 60% securities and 40% fixed income (bonds, treasuries, etc) while the other Indexes listed are comprised 100% of equity securities.

Potential items that may have contributed to this volatility included uncertainty over the timing of the Federal Reserve's interest rate moves, government slow-downs, broad sell-offs in the Chinese markets, and a drop in Brent Crude Oil prices of 24 percent[5].

Uncertainty is a dirty word in the investment community. Investors get skittish when facing the unknown. A focus on the aforementioned issues has detracted from the positive news of strong consumer spending, shrinking unemployment, steady auto sales, lower energy costs, and a healthy housing market. As investors we are told to look at the long term, but we are bombarded with media cawing over the short term. We have to overcome the noise and disruption of our senses in order to retain our long term perspective.

Since an early age, history has always been a subject that has fascinated me. We have history of the sciences, earth, animals, wars, weather, and the markets. "Those who don't know history are destined to repeat it." This quote attributed to the 18th Century statesman and philosopher, Edmund Burke, is as true today as it was over 200 years ago.

In 200 years of stock market history, annualized returns have been positive 71% of the time. We have witnessed nine annual declines of 20% or more and only three of these have occurred in the past 75 years[6]. The 200-year history informs us that markets will ebb and flow, but the overwhelming majority of times they flow in a positive direction.



I've included a recent piece from Weston Wellington along with this commentary that highlights some of the pitfalls of panic selling and market timing. Please give it a read for some additional perspective.

We find it very compelling to maintain the investment strategy that we have mutually agreed upon in creating your personal Investment Policy Statement.

Potpourri

The US department of labor is causing frustration to some advisors over new rules that are in the works which will force advisors to act in the best interest of the client[7]. While we have long adhered to our role as fiduciaries, stock brokers have not been subject to the same standards. After a long a losing fight by the brokerage industry this rule hopefully is about to change.

This quarter we will be re-checking that those of you who are required to take a Minimum Required Distribution from your retirement accounts are on track to do so. If you have outside retirement accounts that we are not aware of, please inform us so that we can help you plan effectively. We will make certain you are in compliance with your total required amounts.

Our best wishes to you for a delightful autumn.

Derek, John, Jon, and Stacie

[1] Grocer, Stephen. "Dow Gets in the Swing", The Wall Street Journal, September 14, 2015.

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[3] "Markets Review & Outlook | Third Quarter", The Wall Street Journal, October 1, 2015.

[4] Performance data; Source: Dimensional Fund Advisors as of 9/30/15.

[5] Krishnan, Barani. "Oil mixed on U.S. crude build, Syria; down 24 percent on quarter", Reuters, September 30, 2015. Accessed October 8, 2015.

[6] Kilgore, Tomi. "Here are 200 years of stock market performance charted as a Christmas tree", Market Watch, December 23, 2014. Accessed October 5, 2015.

[7] Prior, Anna. "Advisors Face More Rules", The Wall Street Journal, September 19, 2015.

The Dow Jones Euro Stoxx 50 is a market capitalization-weighted stock index of 50 large, blue-chip European companies operating within eurozone nations. The universe for selection is found within the 18 Dow Jones EURO STOXX Supersector indexes, from which members are ranked by size and placed on a selection list.

The MSCI Emerging Markets Index is a float-adjusted market capitalization index that consists of indices in 21 emerging economies: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey.

The Nikkei 225, commonly called the Nikkei, is a stock market index for the Tokyo Stock Exchange (TSE). It has been calculated daily by the Nihon Keizai Shimbun (Nikkei) newspaper since 1950. It is a price-weighted index (the unit is yen), and the components are reviewed once a year. Currently, the Nikkei is the most widely quoted average of Japanese equities, similar to the Dow Jones Industrial Average.

The Shanghai Stock Exchange is one of three stock exchanges in China, and the largest in mainland China, established in 1990. The exchange issues both A-shares and B shares, but only B shares can be purchased by all investors (A shares can only be purchased by domestic investors). The SSE Composite Index tracks the performance of the exchange.

Please consider the investment objectives, risks, charges, and expenses carefully before investing in Mutual Funds. The prospectus, which contains this and other information about the investment company, can be obtained directly from the Fund Company or your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

Weston Wellington
Vice President
Dimensional Fund Advisors

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Should Investors Sell After a "Correction"?

Stock prices in markets around the world fluctuated dramatically for the week ended August 27. On Monday, August 24, the Dow Jones Industrial Average fell 1,089 points—a larger loss than the "Flash Crash" in May 2010—before rallying to close down 588. Prices fell further on Tuesday before recovering sharply on Wednesday, Thursday, and Friday. Although the S&P 500 and Dow Jones Industrial Average rose 0.9% and 1.1%, respectively, for the week, many investors found the dramatic day-to-day fluctuations unsettling.

Based on closing prices, the S&P 500 Index declined 12.35% from its record high of 2130.82 on May 21 through August 24. Financial professionals generally describe any decline of 10% or more from a previous peak as a "correction," although it is unclear what investors should do with this information. Should they seek to protect themselves for further declines by selling, or should they consider it an opportunity to purchase stocks at more favorable prices?

Based on S&P 500 data, stock prices have declined 10% or more on 28 occasions between January 1926 and June 2015. Obviously, every decline of 20% or 30% or 40% began with a decline of 10%. As a result, some investors believe that avoiding large losses can be accomplished easily by eliminating equity exposure entirely once the 10% threshold has been breached.

Market timing is a seductive strategy. If we could sell stocks prior to a substantial decline and hold cash instead, our long-run returns could be exponentially higher. But successful market timing is a two-step process: determining when to sell stocks and when to buy them back. Avoiding short-term losses runs the risk of avoiding even larger long-term gains. Regardless of whether stock prices have advanced 10% or declined 10% from a previous level, they always reflect (1) the collective assessment of the future by millions of market participants and (2) the expectation that equities in both the US and markets around the world have positive expected returns.

Exhibit 1 below shows that US stocks have typically delivered above-average returns over one, three, and five years following consecutive negative return days resulting in a 10% or more decline. Results from non-US markets are similar.

Contrary to the beliefs of some investors, dramatic changes in security prices are not a sign that the financial system is broken but rather what we would expect to see if markets are working properly. The world is an uncertain place. The role of securities markets is to reflect new developments—both positive and negative—in security prices as quickly as possible. Investors who accept dramatic price fluctuations as a characteristic of liquid markets may have a distinct advantage over those who are easily frightened or confused by day-to-day events and are more likely to achieve long-run investing success.

Exhibit 1: Returns after Corrections

US LARGE CAP: JANUARY 1926–JUNE 2015				Annualized Compound Return		
Cutoff for Decline	Frequency of Such Declines	Avg. Horizon for Decline (Trading Days)	Avg. Magnitude of Decline	for Next 1 Year	for Next 3 Years	for Next 5 Years
5%	262	4.1	−7.55%	13.24%	9.43%	10.02%
10%	28	4.6	−14.25%	23.56%	8.89%	13.33%

Unconditional annualized compound return for full sample is 9.32%.

INTERNATIONAL LARGE CAP: JANUARY 2001–JUNE 2015				Annualized Compound Return		
Cutoff for Decline	Frequency of Such Declines	Avg. Horizon for Decline (Trading Days)	Avg. Magnitude of Decline	for Next 1 Year	for Next 3 Years	for Next 5 Years
5%	58	4.8	−7.71%	17.30%	9.03%	9.38%
10%	9	5.6	−13.33%	24.73%	12.69%	12.89%

Unconditional annualized compound return for full sample is 4.05%.

EMERGING MARKETS: JANUARY 1999–JUNE 2015				Annualized Compound Return		
Cutoff for Decline	Frequency of Such Declines	Avg. Horizon for Decline (Trading Days)	Avg. Magnitude of Decline	for Next 1 Year	for Next 3 Years	for Next 5 Years
5%	74	4.8	−8.12%	24.82%	11.84%	10.33%
10%	15	5.5	−14.04%	42.23%	13.36%	11.20%

Unconditional annualized compound return for full sample is 9.49%.

Declines are defined as periods with consecutive days of negative index returns with cumulative losses at or above the cutoff. Annualized compound returns are averages across all declines. US Large Cap is the S&P 500 Index, provided by Standard & Poor's Index Services Group. International Large Cap is the MSCI World ex USA Index. Emerging Markets is the MSCI Emerging Markets Index. MSCI data © MSCI 2014, all rights reserved. Past performance is not a guarantee of future results. 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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