Shadforth Financial Group

Investment philosophy

Contents

Executive summary

The multi-billion dollar financial services industry creates distractions that prevent investors from achieving their objectives.

Market 'noise' focuses attention on the relatively unimportant issues of market timing, stock picking and attempts to predict the future. There is a misplaced belief that better forecasting is the value-add of an advice business. Through our studies, research and experience, we employ an evidence based approach that continues to produce lower volatility in portfolios and higher returns than the average investor.

We understand our role as Advisers is to help investors make systematically smart decisions about their money. We believe that educated investors are the most successful investors.

These beliefs are supported by an overwhelming body of academic evidence regarding the science of capital market investing and directly govern how we construct portfolios to meet our clients' needs and objectives now, and through ongoing research and investigation, into the future.

In summary, our key investment beliefs are:

1. **Investing is Not Speculating** – Investors are entitled to their share of the capital market rate of return on their assets over time and this is accomplished by exposing capital to the various available asset classes and sub-asset classes in expert fashion. Importantly, the return achieved from an asset class can take long periods to emerge. This is normal and efforts to short-cut normal long-term returns are speculative and often introduce unnecessary and unrewarded risks into the portfolio.
2. **Markets Work** – Prices for financial assets find equilibrium eventually and it is difficult to consistently predict and profit from any perceived inefficiencies in these prices. Importantly, the capital market rate of return is available to every investor at a reasonable price and the rate of return generated over the long-term has proved to be attractive.

> There is a commercial imperative driven by a multi-billion dollar industry that keeps our focus on the relatively unimportant aspects of market timing, stock picking and prophesying the future. The great false hope: "Searching for financial gurus".

3. **Risk and Return are Related** – Over the long term, the higher the risk, the higher the potential return. Over the short term, however, risk and return can become disconnected, where taking higher risk produces low returns. It is certainly possible to outperform markets, but only by accepting increased risk. Not all risks are worth taking. Certain risk factors can be controlled to minimise risk and aid long term return. Remaining invested is a key risk management tool.
4. **Diversification is Essential** – Concentrated, non-systematic risk is unrewarded in investment portfolios over time. Diversification is the antidote to many avoidable risks. Therefore, investment portfolios should be comprehensively diversified across and within asset classes and sub-asset classes.
5. **Portfolio Structure (Asset Allocation) Explains Performance** – The dominant contributor to portfolio performance is the relative exposure of capital to the various asset classes and sub-asset classes. Use of sensible strategic asset allocation, together with careful rebalancing, is likely to be more rewarding than speculative strategies such as market timing or tactical asset allocation.
6. **Costs and Taxes Matter** – Investment portfolios should be constructed and maintained with costs and taxes in mind. Costs and taxes may be implicit or explicit in an investment portfolio.
7. **Discipline is Paramount** – Investor behaviour is a major contributor to portfolio performance, both positive and negative. The media and the financial services industry tend to swamp investors with short term distractions and this can encourage unrewarded activity in portfolios. Numerous studies prove beyond doubt that investors can cause considerable harm to their portfolios by deviating from sound long term investment practices in the misplaced belief that short term market events can be managed.

We premise our investment philosophy on the following points:

Executive summary continued

Capitalism – Investors will usually apply their funds in the capitalist economies of the world, where both labour and capital are allocated to achieve the best financial outcome. Generally, greater levels of risk translate into higher levels of return over time.

Financial Markets – Financial Markets facilitate the process of capital exchange in economies. The broad financial market types (Debt and Equity) are themselves comprised of smaller asset classes and sub-asset classes.

Financial Assets – Financial Assets are the key component of financial markets. Financial assets are only those instruments that produce returns by way of income or a share of profits to the investor. We exclude personal possessions and an investor's principal place of residence from the definition of financial assets.

Asset Classes and Sub-Asset Classes – Where financial assets are similar in their structure and/or behaviour, they are usually grouped into asset classes. The most common asset classes are:

- Cash
- Australian Fixed Interest & Income Securities
- Global Fixed Interest & Income Securities
- Australian and International Listed Property Securities
- Unlisted Property Securities
- Australian Equities
- Global Equities.

Financial Asset Pricing (Market Equilibrium) – Although the pricing of assets is complex, the millions of inputs contributing to financial asset pricing mean that financial markets usually price assets accurately over the long term. That is, markets are broadly efficient or achieve price equilibrium over the long term. However, markets can be significantly mispriced over the short term, when prices at both the stock and overall market level do not reflect the intrinsic value.

> "To invest successfully over a lifetime does not require a stratospheric IQ, unusual business insight, or inside information. What's needed is a sound intellectual framework for making decisions and the ability to keep emotions from corroding that framework."
>
> *Preface by Warren Buffett in "Intelligent Investor" by Benjamin Graham*

Risk Factors – Risk is a significant variable in an investor's portfolio and there are many different forms of risk confronting investors. Some of the various risk types can be harnessed to help produce a successful long term investment outcome. Other risks are not worth taking. Time invested and diversification of financial assets are the two most powerful means of managing and minimising many risks common to investors.

The abovementioned beliefs lead us to construct portfolios using long term benchmarks *across* asset classes. This is known as Strategic Asset Allocation. In addition, we also build portfolios to provide comprehensive diversification *within* each asset class by allocating capital to sub-asset classes in a logical manner.

Investment philosophy

In the following pages, we outline the core issues and beliefs of our investment philosophy as these views underpin how we construct investment portfolios for our clients. There are various methods and investment strategies that could be adopted within your portfolio, including:

- Enhanced Asset Class Investing
- Indexing
- Active Management (with or without direct share exposure)
- A combination of the various approaches.

Our research focuses on analysing all of these investment strategies to assess their core strengths and weaknesses. Your adviser is therefore able to manage your portfolio using the strategy that is most appropriate for your circumstances.

ENHANCED ASSET CLASS INVESTING

Enhanced Asset Class Investing embraces over 50 years of academic research conducted by leading financial economists and business schools (including several Nobel Prize winners). It is the basis for achieving superior risk adjusted long term returns in portfolios. It is a highly rigorous and disciplined means of constructing a broadly diversified investment portfolio and is more highly developed than traditional investment advice approaches.

The principles of Enhanced Asset Class Investing are not only well documented, but measurable. They have been proven over time in every market around the world. The development of computer technology has enabled numerous academic studies to be conducted, analysing over 80 years of investment market data from multiple markets. Many of these studies are either referenced in this document, or shown in the *Appendix*.

> The SFG Investment Philosophy allows clients to structure their financial plans with greater precision and focus. The correct weighting to each of these investment strategies and styles will be outlined by Advisers, based on a client's specific personal situation and needs.

The academic contribution to Enhanced Asset Class Investing includes:

Paul Samuelson (Nobel Laureate in Economics 1970) – demonstrated that market prices are best estimates of the value of a company and that changes in market prices follow random patterns that are unpredictable.

Harry Markowitz (Joint Nobel Laureate in Economics 1990) – the father of Modern Portfolio Theory. Markowitz demonstrated that diversification reduces risk within portfolios by reducing the specific risk of individual assets. Prior to Markowitz, conventional wisdom was to analyse individual securities and then concentrate holdings in 'superior' stocks based on financial strength and dividends.

William Sharpe (Joint Nobel Laureate in Economics 1990) – the founder of the Capital Asset Pricing Model (CAPM). Sharpe, via the CAPM, demonstrated that the expected return of a portfolio is related to the risk of the portfolio relative to the market(s). If a portfolio has higher risk relative to the market, its expected return (or loss) will be greater than the market, and vice-versa.

Merton Miller (Joint Nobel Laureate in Economics 1990) – demonstrated that financially distressed, 'unhealthy' companies have a higher cost of capital and therefore provide a higher expected return to investors.

Eugene Fama – by demonstrating that financial markets absorb information into securities prices swiftly, Fama coined the term Market Efficiency. Fama also teamed with Ken French to reveal the higher systematic returns that can be achieved by holding a portfolio of 'Value' stocks (discussed below).

Ken French – in conjunction with Fama, French was able to conclusively prove a 'Value' premium can be captured in portfolios, if the securities held exhibit higher levels of book assets relative to price than a market portfolio.

Rolf Banz – first documented that an attainable 'Size' premium exists in the returns of a portfolio of small companies, compared to large companies.

Investment philosophy continued

The aim of Enhanced Asset Class Investing is to distil the findings of these major advances in research, to ensure that the best of these strategies can be implemented in real client portfolios, and to help ensure that investor wealth is not eroded by unrewarded practices or other portfolio inefficiencies. Investors who stay disciplined to the evidence-based asset class management methodology will reap the rewards over time. In a sense, our clients' portfolio managers are now the world's top financial economists.

In summary, some key points of differentiation are that enhanced asset class investing:

- Assumes markets work efficiently
- Efficiently captures specific dimensions of risk identified by academic research without forecasting
- Accepts tracking error in order to minimise transaction costs and enhances returns through portfolio design and trading.

INDEXING

Some think that Enhanced Asset Class Investing is indexing but it is absolutely not. Indexing, or index investing, is just that – buying the index.

Indexing:

- Assumes markets work with no liquidity cost
- Uses commercial benchmarks to dictate strategy
- Accepts high transaction costs and turnover in favour of tracking.

Because indexing does not attempt to capture size or price related risk factors, indexing generally underperforms enhanced asset class investing over any reasonable time frame.

ACTIVE MANAGEMENT

Some investors prefer to utilise a more active approach to investing. The objective of incorporating active management for a portion of a portfolio is to provide increased potential to generate performance above the market average and potentially further enhance diversity.

Active management:

- Assumes markets don't always work efficiently and can over or under shoot
- Assumes value and price can become disconnected
- Attempts to beat the market through forecasting and security selection
- Can avoid investing in undesirable securities
- Generates higher turnover, transaction costs, and taxes.

Active management can be employed through either direct investment, or through actively managed funds which provide exposure to professional portfolio managers.

There are a variety of active managed fund approaches in the market place and we carefully review each of the investment styles available to ascertain if one of the styles could be appropriate, based on the overall objectives for your portfolio, your risk tolerance and personal situation. In particular, emphasis is placed on the selected managers displaying consistency of style over a reasonable period of time, in addition to a strong track record in terms of performance and risk management.

Based on this analysis, we may select and recommend active investment managers who utilise some of the following investment styles:

Quantitative

Quantitative investing (usually shortened to "quant") uses a number of formulas and models to calculate a share's relative worth compared with other shares in the market. If the relative price of a share appears cheap, a manager buys the share. If it appears expensive, the share is sold. The models are based on a number of different investment factors which identify price, value, growth potential and market sentiment. A quant approach takes the emotion out of decision making, relying on intensive data analysis to make the buy/sell decision. That said, it may also take out some of the potential investment insight.

Thematic

Thematic fund managers look for broad economic, social and political themes to guide their investment decisions, e.g. the healthcare sector which, with an ageing population, may be expected to perform well in coming years. Once the theme is identified, managers will focus on buying the best companies within the appropriate sectors.

Growth

Growth managers seek companies that offer stronger growth prospects or are likely to grow earnings faster than GDP. These stocks often command a premium price as they are 'in favour' companies, and are identified typically by higher P/E ratios, lower book value to market value and high price to cashflow ratios.

Growth at a Reasonable Price (GARP)

This investment approach seeks to identify companies that have better than average growth prospects, but are still attractively priced. It is acceptable to pay a high price for a stock, if that stock's share price is likely to appreciate more than its peers. In essence, strong growth should command a premium, but that premium has to be demonstrable before investing.

Value

Fund managers using the value investment style will tend to buy shares whose price looks cheap. Value managers will often buy shares that are out of favour and appear cheap, while selling shares that are currently popular or in favour, and appear expensive.

Direct Shares

Shadforth Financial Group owns a stock broking licence, and as such Advisers have the capability to offer tailor-made solutions to suit client needs and requirements. A direct share portfolio can be constructed to emulate the various investment styles described above if appropriate.

SUMMARY

In short, the SFG Investment Philosophy allows clients to structure their financial plans with greater precision and focus. The correct weighting to each of these investment strategies and styles will be outlined by Advisers, based on a client's specific personal situation and needs.

To elaborate on the basic building blocks of our approach, we note the following observations about investing, markets, risk and implementation.

Capitalism & financial markets

Capitalism is entrenched as the dominant economic force in the world and the majority of investors will allocate their investment capital within capitalist economies.

A core tenet of the capitalist system is that on average, its participants will direct both their labour and capital to where they may get the best price, in pursuit of the greatest profit. Generally, the pursuit of higher return will also involve higher risk.

> Financial markets exist to help determine a price for the allocation of capital between participants, depending on the forces of supply and demand.

Financial markets exist to help determine a price for the allocation of capital between participants, depending on the forces of supply and demand. In order to facilitate the process of capital exchange, two broadly different financial markets have developed. They are:

- Debt markets
- Equity markets.

Debt Markets

Debt markets manage the process of borrowing and lending between participants in financial markets. Debt markets exist specifically so multiple borrowers and lenders can negotiate the appropriate price for the exchange of capital (i.e. an interest rate). Typical examples of investments categorised under the heading of debt include:

- Bank accounts
- Term deposits
- Debentures
- Government bonds
- Corporate bonds
- Mortgages.

These are often referred to as "defensive" assets.

Equity Markets

In equity markets, investors contribute capital in a way which provides them with a share of 'ownership of the business enterprise'. The return to investors in this type of market is through a share of the profits (or losses) of the business enterprise over time. Typical examples of investments in equity markets include:

- Shares in listed companies (domestic or global)
- Shares in private companies (private equity/venture capital)
- Interest in partnerships
- Any other interest in a business enterprise
- Listed and unlisted property.

These are often referred to as "growth" assets.

Property

There is often debate as to how to categorise property when considering the two broad traditional financial markets of debt and equity. Research demonstrates that listed property (also known as Real Estate Investment Trusts, REITs) is a separate asset class distinct from both fixed interest assets and equity assets.

Returns from REITs come from two sources, being income from rents and returns from capital growth, property development and property management. The stream of rental payments is similar to a fixed income investment, while the potential for capital growth is similar to an equity investment. Over time the proportion of the return generated by each source may vary but given the potentially high volatility of the REIT sector we consider it prudent to treat property as a growth asset. We further believe that portfolios should have exposure to both Australian and international property securities.

The common theme amongst Debt, Equity and Property markets is that they all contain instruments known as 'financial assets'.

FINANCIAL ASSETS VERSUS LIFESTYLE ASSETS

Investing is a process of dealing with financial assets. A financial asset by our definition is one which produces, or has the potential to produce, a return in the form of interest, rent or a share of profits (dividend or gain). Therefore, any use of capital that will not result in one of these outcomes should not be regarded as a financial asset.

An example is a lifestyle asset, such as a principal place of residence (i.e. a client's home). A home essentially represents 'shelter' and does not usually produce income. Therefore, in constructing investment portfolios, we consider a home (or an un-rented holiday home), to not be a financial asset, for income reasons.

Usually, any capital growth associated with a principal home over time is often transferred to the next residence and is seldom liberated to release any capital gain. Any surplus value or capital growth arising from the sale of a home will only become a financial asset once it has been transferred into income producing investments.

Other items such as art, antiques and collectibles also tend to not fit our definition of a financial asset. Movements in price of these items are due to the relative scarcity of the items and speculation on future price increases. We believe these items are better categorised as possessions. They tend not to produce income and their valuation is generally a highly subjective and emotive process.

We believe it is important that our focus for investment is only upon financial assets that fit the above definition.

Asset Classes and Sub-Asset Classes

Although most financial assets have derived from debt or equity markets, several distinct *'asset classes'* have emerged within these markets. They are considered separate asset classes because they are recognisably different from each other, and behave in different ways. That is, they exhibit independent risk and return characteristics.

In order to incorporate the common terminology used in modern financial markets, this document refers to seven key asset classes as follows:

- Cash (Debt market)
- Australian Fixed Interest & Income Securities (Debt market)
- Global Fixed Interest & Income Securities (Debt market)
- Direct Property (Equity market)
- Listed Property (Equity market)
- Australian Equities (Equity market)
- Global Equities (Equity market).

Importantly, many of these major asset classes may be divided further into sub-asset classes'. The differences between asset classes or sub-asset classes are evident in a number of important respects, including:

- Type of income generated (interest, rent or dividends)
- Term of the investment
- Volatility
- Risk of capital loss
- Location, operation and structure of the underlying market.

Importantly, sub-asset classes should exhibit sustainable, independent risk and return characteristics and therefore they bring an individual return premium and diversification benefit to an investment portfolio.

Academic research on the behaviour of securities within capital markets has clearly proven that the performance of investment portfolios is directly attributable to the weighting of a portfolio to sub-asset classes,

Table 1: Asset classes and sub-asset classes available to investors

Defensive assets	**cash**		
	fixed interest	*Australian*	Government debt
			corporate debt
		Global	Government debt
			corporate debt
Growth assets	**property**	*Australian*	REITs (commercial, industrial, retail, leisure)
			unlisted property
		Global	REITs (commercial, industrial, retail, leisure)
			unlisted property
	equities	*Australian*	large
			small
		Global	large
			small
			regional / emerging markets

Capitalism & financial markets continued

such as 'Large cap' or 'Small cap' companies in the case of Australian and global equities. These equity sub-asset classes are functions of the risk/return characteristics of the underlying stocks.

Large companies represent the majority of the sharemarket by market capitalisation. For example, in Australia the top 100 companies by size are considered Large and by holding them in market-weighted proportions an investor has effectively captured the market in question. By contrast, 'Small cap' companies exist outside the top 100 group and though higher in actual number, these companies essentially represent only 10 to 15 percent of any sharemarket capitalisation. However, the expected return of small companies as a whole is generally higher than large companies, for reasons of inherent risk.

Table 1 (page 9) summarises our broad view of the asset classes and sub-asset classes available to investors.

The Importance of Asset Allocation

Knowing the different asset classes and sub-asset classes available to investors, and combining them in a mix to build a portfolio, are the two most important contributors to a portfolio's performance over time (see Graph 1).

Expected portfolio returns are therefore more shaped by the proportion invested in the various asset classes (shares, property, fixed interest and cash) than by other contributors to portfolio performance.

Financial Asset Pricing

Several key issues contribute to the process of determining the price of an individual financial asset within an asset class or sub-asset class. Therefore, it is vital to examine and understand how financial assets are priced by financial markets. As previously described, the key purpose of financial markets is to find a price at which participants are prepared to exchange their capital. The price achieved is an outcome of a large number of factors including:

- Book (or accounting) value
- Expected future income
- Prevailing supply and demand
- Inherent risks (to both capital and income)
- The present value of future income streams
- The term of the investment
- Liquidity.

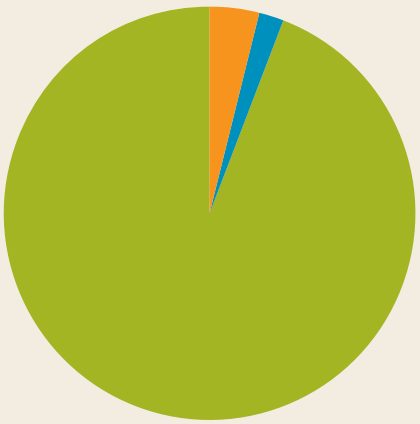
For example, the price an investor pays for a company listed on the Australian Stock Exchange (ASX) could be influenced by:

- The company's net tangible assets
- The company's net cashflow and its ability to consistently make and increase its profits
- The expected future dividends to shareholders (and the certainty of those dividends)
- The company's franchise and reputation
- The rate of return available from an alternative asset class
- Ease of disposal via the market (liquidity).

Accordingly, the factors affecting price are changing constantly and rapidly in financial markets, and competition for investment capital is strong.

It should be remembered that prices in financial markets may not achieve equilibrium quickly. Price and value can become disconnected, sometimes for long

Graph 1: Portfolio performance is linked to portfolio mix



Asset class selection (94%)
How assets are allocated in a portfolio.

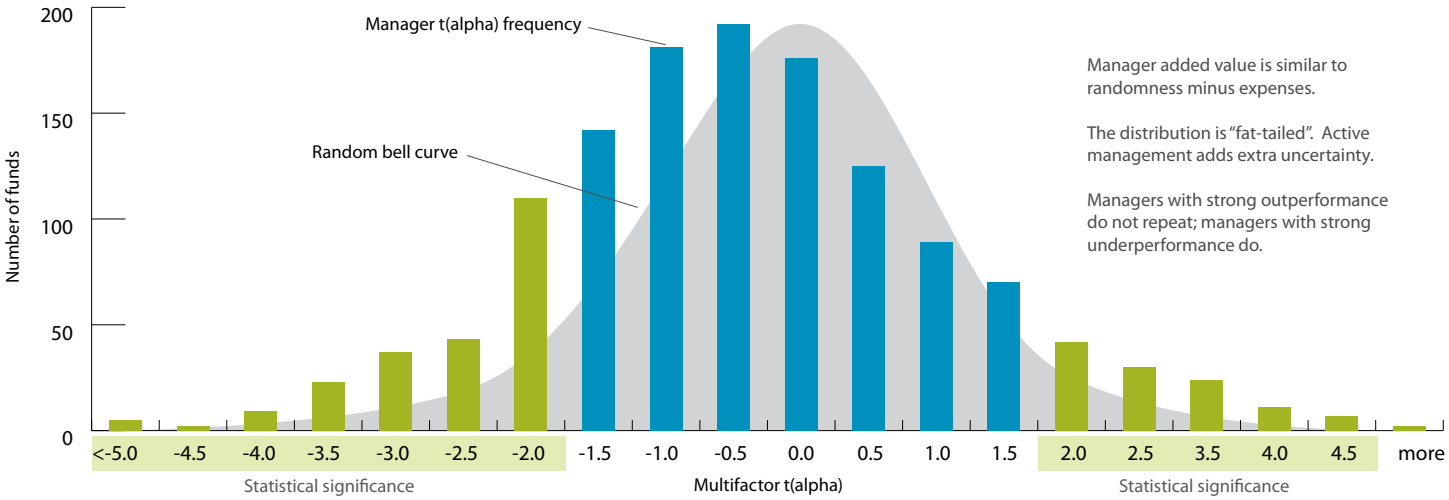
Market timing (2%)
Shifting portfolio assets in and out of the market or between asset classes.

Security selection (4%)
Finding "underpriced" companies or industries.

NB: The vast majority of a portfolio's return is determined by asset allocation selection; and only a small portion is determined by market timing and security selection.

Source: Gary P. Brinson, L. Randolph Hood and Gilbert L. Beebower, 'Determinants of Portfolio Performance', Financial Analysts Journal, July-August 1986, pp.39-44; and Gary P.Brinson, Brian D. Singer and Gilbert L. Beebower, 'Revisiting Determinants of Portfolio Performance: An Update', 1990, Working Paper.

***Graph 2: Value added of active management vs chance** (distribution of multifactor t(alpha) 1,302 managers, 1962-1995)*



periods of time, where the price of a security does not bear any relation to the intrinsic value of the future dividend stream. This may occur through excessive optimism or pessimism, or simply from a fundamental lack of understanding of the intrinsic value of the security. The prices paid for technology stocks in 1998-2000 are a good example of price disconnecting from value.

Given the sheer number of participants engaging in transactions for each and every financial asset, and considering the efforts made to structure markets using effective and fair pricing mechanisms, it is therefore:

- Difficult to predict future prices for financial assets accurately in financial markets; and
- Difficult to profit from any perceived inefficiencies in financial markets consistently over time.

This has considerable implications for professional money managers who attempt to outperform the market by using investment techniques designed to predict present or future asset values. Numerous studies in Australia and overseas demonstrate that while there are always active managers who outperform a benchmark (such as a market index) over some periods, this outperformance may not necessarily be repeated in subsequent periods. This can be due to a number of reasons, one of which may be their investment style which can become out of favour over certain periods.

For example, a "value-style" manager will tend to underperform during periods when markets are enjoying strong growth. Similarly, small caps tend to underperform when investors become more risk averse and seek to invest in larger, dividend paying companies. Our research on active managers continues to focus on targeting individual investment managers with skills who can demonstrate an ability to generate outperformance over the long term. Any active managed funds or direct shares recommended for clients are designed to provide complementary benefits and diversification to an underlying portfolio.

An investor relying on forecasting techniques always needs to know those managers who will be likely to outperform in a given period, in advance. Producing such a result in practice is difficult to achieve consistently over time, and the effort in doing so also produces the unwanted side-effect of additional costs and taxes in a portfolio (see Graph 2).

Substantial academic research has been undertaken in this regard and we have included a list of academic papers and publications that deal with this and other topics central to our investment philosophy in the *Appendix*.

Tax is also a key consideration in portfolio construction, as many investment portfolios are owned by taxable structures (such as personal or superannuation ownership). Investment styles recommended for a portfolio will therefore take into account the tax rate relevant to the underlying entity holding the portfolio.

Managing risk

RISK FACTORS

Risk is central to any discussion of financial assets, financial markets and investing. In fact, without risk there would be no investment return available to investors. Having said this, it is important to determine which risks are worth taking, and those that should be avoided.

Theoretically, all investors should be able to access a 'risk free' rate of return. While there is some argument as to whether there is any such thing as 'risk free', it is generally accepted that a risk free rate of return in Australia is the 'cash' rate. Where capital is allocated to assets other than those which deliver the risk free rate of return, investors will generally expect a higher return as a reward for the additional risk involved. That is, risk and return are related.

Risks take a number of forms depending on the type of financial asset chosen. The most relevant risks to our clients are:

- **Inflation Risk** – The real purchasing power of an investor's capital may not keep pace with inflation.
- **Market Risk (Volatility)** – The movement of prices for financial assets in financial markets may affect an investor's capital value in the short to medium term. This can be positive or negative.
- **Capital Risk (Risk of a Loss)** – An investor's portfolio will be affected by the quality of each financial asset held and the number of financial assets held.

These major risk areas are themselves driven by a range of sub-factors. For example, Capital Risk might prevail in an investor's portfolio as a result of 'Credit Risk', because the portfolio has been constructed using financial assets from an institution with a poor credit rating. Equally, Market Risk (volatility) and Capital Risk may affect an investment portfolio because an investor owns a concentrated range of financial assets and has therefore failed to adequately diversify.

These and other risk factors provide some explanation as to why returns from different asset classes and sub-asset classes can vary so widely over time. It explains why there is an 'equity premium' available to investors for investing in equities instead of bonds (fixed interest).

Finally, it is worth remembering that risk premia ebb and flow over time depending on prevailing economic and market conditions. It is therefore possible for asset classes and sub-asset classes to exhibit varying levels of expected return (a function of their respective risk premia) in short to medium term periods.

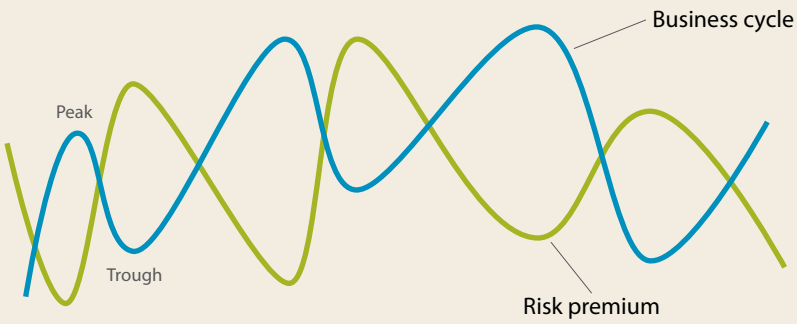
This effect is illustrated in Graph 3, which shows the indicative relationship between the Business Cycle and the inherent risk premium present in an asset class over time. Clearly, as conditions improve in the economy, risk decreases and so does expected future return. The reverse is true when conditions are poor.

MANAGING RISK

While risk and return in investment portfolios are certainly related, some risk factors can be minimised or controlled to aid the performance of the portfolio itself. We believe that the two major risk areas confronting clients (discussed above) can be largely controlled by focussing on two key areas:

- Understanding the impact of time on risk
- Understanding the importance of diversification on risk.

Graph 3: Risk and the business cycle



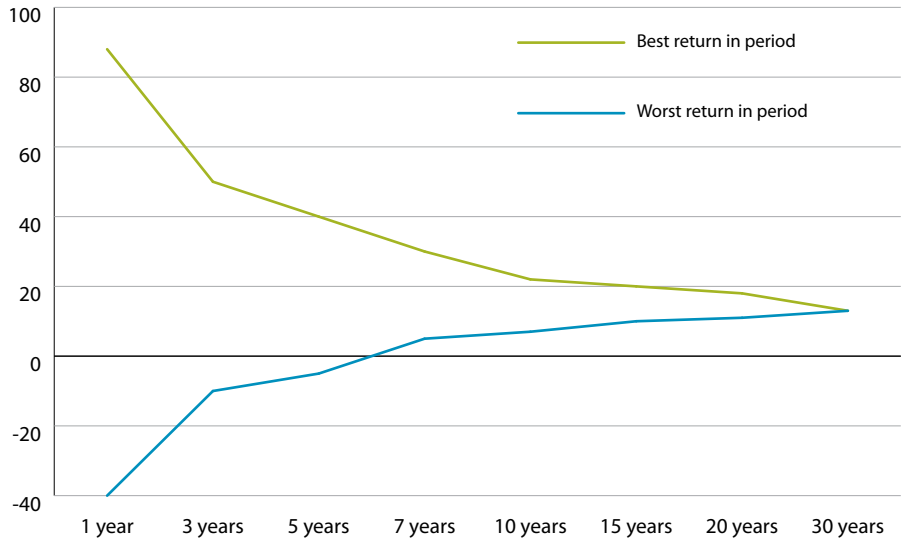
Risk aversion increases when the business cycle turns down.
To attract investors to risky assets, expected risk premiums should increase during bad economic times.

Source: Dimensional. Business Cycles and Risk Premiums. Inmoo Lee, Eduardo A. Repetto and L. Jacobo Rodriguez.

"We have no idea and never have whether the market is going to go up, down, or sideways in the near or intermediate future."

Warren Buffett – Berkshire Hathaway Annual Report 1988

Graph 4: Historical range of percentage equity market returns, January 1960 – June 2009



The Impact of Time on Risk

The amount of risk inherent in an asset class or sub-asset class tends to reduce over time. In other words, the longer an investor is prepared to remain invested in an asset class or sub-asset class, the less likely they are to suffer a loss, or other poorer than expected result.

This is amply illustrated in the following chart. Graph 4 shows the maximum and minimum returns from the Australian equity market over different periods of time. In the shorter term, (1 to 3 years) the potential difference in returns is dramatic (both positive and negative). However, over more extended periods of time the variation in potential returns reduces greatly. This inter-relationship between risk and time is a core issue for successful investing.

The Risk of Market Timing

Table 2 shows the returns of various asset classes over a 25 year period, together with inflation. The table clearly illustrates the significant variation in returns from asset classes when measured over different timeframes and highlights the importance of remaining invested in these asset classes over long periods of time.

It also demonstrates that the returns generated from the capital markets are themselves available at a reasonable premium above inflation and that pursuing the capture of the capital market rate of return from financial markets is a worthwhile objective.

We therefore believe that portfolios should only be constructed according to a long term, strategic asset allocation benchmark. This helps remove the temptation to 'switch' investment asset classes to potentially achieve a higher return. This is known as 'market timing' or 'tactical asset allocation' and is generally unrewarded, because future prices for financial assets are difficult to predict and the negative impact of costs

Managing risk continued

***Table 2: Current multi-period returns** (rolling return periods January 1982 - June 2009)*

	Inflation*	Cash	Listed Property	Australian Equities	Global Equities
3 Month	0.12	0.78	15.17	11.29	3.77
6 Month	0.10	1.75	-12.90	9.08	-8.28
1 Year	1.55	5.47	-42.27	-20.14	-16.31
2 Year	3.05	6.40	-39.65	-16.29	-19.30
3 Year	2.71	6.41	-22.66	-3.82	-10.57
Total Period	4.17	7.47	9.30	11.62	10.43

Key: Inflation – Australian Consumer Price Index; Cash – UBS 90 Day Bank Bill Index; Listed Property – S&P / ASX 200 Listed Property Accumulation Index; Aust. Equities – S&P / ASX 200 Accumulation Index; Global Equities – MSCI World Index in $A (Unhedged)

*Note: inflation to May 2009

and taxes when switching financial assets or asset classes is considerable.

Consider Graph 5, which shows the diminishing level of returns achieved by missing some of the best individual days in the Australian equity market. Although the time period for the chart is over a decade in length, missing only 25 of the best trading days greatly damages the return achieved by an investor who instead simply remained invested in the asset class, and didn't succumb to the temptation to time markets.

Similarly, Table 3 shows the best and worst performing asset class each calendar year since 1989. The random nature of asset class returns, even over this relatively short period of data, is self-evident. As discussed, there is also abundant evidence to indicate that even professional investors do not have the capacity to consistently identify the appropriate time to be in or out of asset classes or particular financial assets.

While it will always be possible to point to records of success in selecting one asset class or financial asset over another in hindsight, in practice it is very difficult to do so in advance and as such, the pursuit of such a goal is an unreliable way to approach portfolio construction. This extends to the timing of currency decisions within Global Equities, Global Property and Global Fixed Interest as well.

Graph 6 summarises a range of studies comparing certain market (or index) performances, against that of the average investor.

We consider that advice is critical to an investor's success. While it is certainly true that market forces are a huge influence on ultimate return, an equally large component of success or failure is an investor's own behaviour and discipline.

Enhanced Asset Class Investing is structured to avoid unrewarded practices in the process of building investment portfolios. Among other guiding principles, our investment philosophy contends that it is 'time in' the markets rather than 'timing' the markets, which should deliver the best results for investment portfolios over time. However, this is based on the assumption that the investor can tolerate the periodic swings in the markets' performance.

***Graph 5: Risk of market timing** (S&P/ASX 300 Accumulation Index, June 1992 - Dec 2008)*

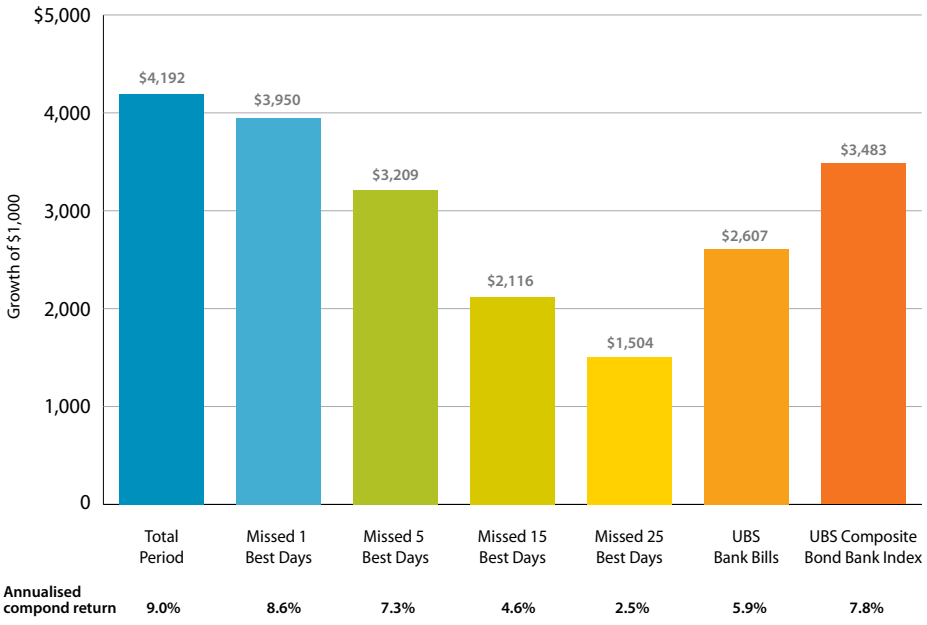
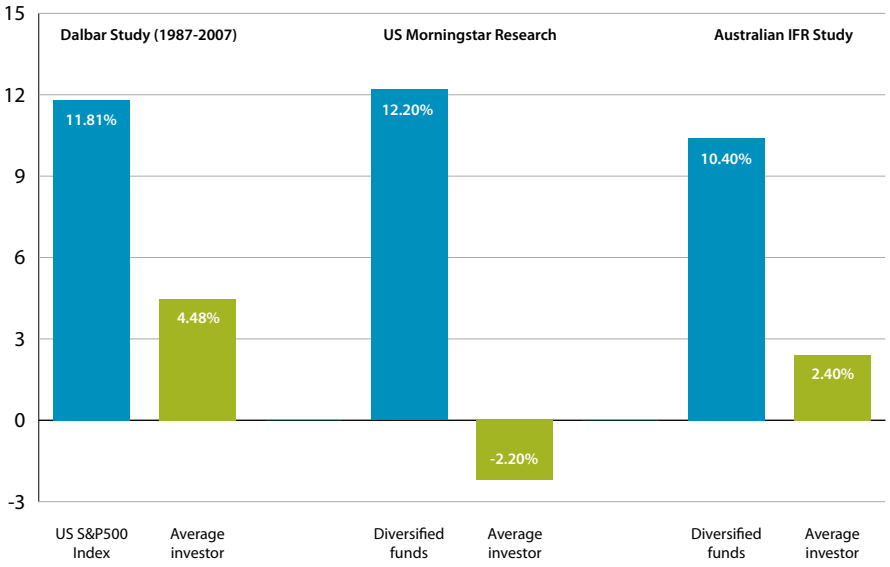


Table 3: Asset class returns, 1989-2008

	Cash	Australian Fixed Interest	Global Fixed Interest	A-REITs	Global REITs	Unlisted Property	Australian Shares	Australian Small Caps	International Shares	Emerging Markets
31-Dec-89	18.4%	0.0%	0.0%	2.3%	0.0%	18.4%	17.4%	0.0%	26.2%	-7.3%
31-Dec-90	16.1%	19.0%	14.1%	8.7%	-21.3%	1.1%	-17.5%	0.0%	-15.1%	-1.3%
31-Dec-91	11.2%	24.7%	18.9%	20.1%	-1.7%	-13.0%	34.2%	18.9%	20.0%	62.5%
31-Dec-92	6.9%	10.4%	10.1%	6.6%	-1.1%	-7.0%	-2.3%	-3.7%	4.6%	22.8%
31-Dec-93	5.4%	16.3%	13.5%	30.0%	54.3%	-2.6%	45.4%	64.5%	24.2%	77.5%
31-Dec-94	5.4%	-4.7%	-2.5%	-6.3%	-10.8%	14.4%	-8.7%	-9.0%	-8.1%	-18.9%
31-Dec-95	8.0%	18.6%	20.6%	14.3%	14.7%	7.7%	20.2%	12.5%	26.0%	-1.2%
31-Dec-96	7.6%	11.9%	9.5%	14.2%	26.4%	7.9%	14.6%	28.3%	6.2%	-0.7%
31-Dec-97	5.6%	12.2%	10.7%	21.8%	14.1%	6.8%	12.2%	-1.9%	41.6%	7.8%
31-Dec-98	5.1%	9.5%	10.1%	18.4%	-6.6%	9.6%	11.6%	3.7%	32.3%	-20.7%
31-Dec-99	5.0%	-1.2%	0.3%	-4.2%	1.4%	9.8%	16.1%	24.8%	17.2%	56.0%
31-Dec-00	6.3%	12.1%	9.7%	18.9%	30.9%	11.3%	4.8%	-14.7%	2.2%	-18.3%
31-Dec-01	5.2%	5.4%	8.3%	14.8%	9.1%	9.8%	10.5%	1.8%	-10.0%	5.7%
31-Dec-02	4.8%	8.8%	11.6%	11.8%	6.2%	10.7%	-8.6%	-9.1%	-27.4%	-14.7%
31-Dec-03	4.9%	3.0%	6.6%	8.8%	30.9%	11.9%	15.0%	32.3%	-0.8%	16.5%
31-Dec-04	5.6%	7.0%	8.9%	32.2%	33.9%	11.9%	27.9%	26.6%	9.9%	20.7%
31-Dec-05	5.7%	5.8%	6.6%	12.7%	15.8%	14.0%	22.5%	19.6%	16.8%	43.2%
31-Dec-06	6.0%	3.2%	4.4%	34.1%	37.7%	18.8%	24.5%	34.2%	11.5%	23.0%
31-Dec-07	6.7%	3.5%	6.6%	-8.4%	-16.9%	21.1%	16.2%	17.1%	-2.6%	25.1%
31-Dec-08	7.6%	15.0%	9.2%	-55.3%	-42.6%	-0.3%	-38.9%	-53.2%	-24.9%	-41.2%

Graph 6 : Sticking to the strategy – performance of average investors vs diversified funds and US S&P500 Index



There will be many occasions when the markets experience major dislocations and when capital values fall dramatically. The investor should clearly understand their tolerance for such events and the time required to recover their capital.

We maintain that a successful investment experience is grounded in firstly understanding the structure and behaviour of asset classes and sub-asset classes, and then achieving a mix of asset classes and sub-asset classes appropriate to the individual investor's risk tolerance. The resulting Strategic Asset Allocation should then be the only benchmark against which future rebalancing decisions are made.

Managing risk continued

The Importance of Diversification

Diversification is the process of ensuring that an investment portfolio has an exposure to a number of different asset classes, sub-asset classes and individual financial assets, rather than being entirely concentrated in any one of these.

The key to the process is that different asset classes will usually not move in unison. For example, in a period when share markets are performing poorly, property markets may be performing well.

As a result, having an exposure to both asset classes in this example reduces the risk of only being exposed to the poorly performing asset class. This is colloquially referred to as avoiding having "all your eggs in one basket".

Consider Table 4 below, which illustrates the correlation of the major asset class and sub-asset class components of a portfolio. A correlation of 1 indicates that two components move in exactly the same direction as one another, at the same time. A correlation of –1 indicates a perfectly uncorrelated matching, and a correlation of 0 suggests no strong correlation exists.

As might be expected, the equity asset classes (Australian and international shares, Australian and international small companies and REITs) are relatively highly correlated with each other, implying that they offer less diversification benefit in a portfolio context. In contrast, cash, fixed interest and commodities are less correlated to equities and thus provide better portfolio diversification benefits.

In practice, no two financial assets, asset classes or sub-asset classes should be either perfectly correlated or perfectly uncorrelated. Rather, the degree to which the correlation of two components moves away from 1 towards zero, (or even negative), indicates a clear diversification benefit to the investment portfolio, because of a weak correlation.

We have already established that investors have little ability to consistently pick the best asset class, sub-asset class or financial asset in advance. As a result, evidence suggests that a diversified portfolio will reduce risk without necessarily forgoing investment return. The key is lowering the risk of experiencing negative returns over time.

Diversification takes two broad forms:

- Across asset classes (and sub-asset classes)
- Within asset classes.

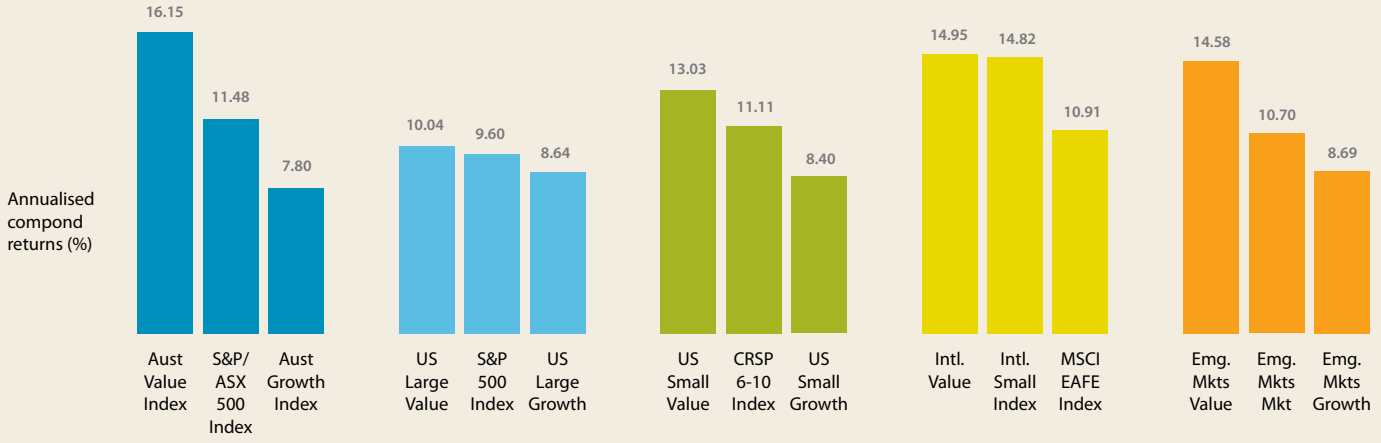
Diversification across asset classes

This is achieved by including an exposure in an investment portfolio to more than one asset class (i.e. cash, income securities, property and equities). As described earlier, the process of diversifying financial assets across different asset classes is often referred to as the process of 'Asset Allocation', and is arguably the most important contributor to portfolio performance. We specifically advocate Strategic Asset Allocation rather than Tactical Asset Allocation (or trying to forecast news and events, and time the

***Table 4: Correlations of asset classes & sub-asset classes** (January 1999 – June 2009)*

	Cash	Australian Fixed Interest	Global Fixed Interest	A-REITs	Global REITs	Unlisted Property	Australian Shares	Aust Small Caps	International Shares	International Small Caps	Emerging Markets	Commodities
Cash	1											
Australian Fixed Int.	0.32	1										
Global Fixed Interest	0.00	0.69	1									
A-REITs	-0.50	-0.33	0.01	1								
Global REITs	-0.40	-0.31	-0.01	0.90	1							
Unlisted Property	0.18	-0.51	-0.19	0.53	0.49	1						
Australian Shares	-0.30	-0.56	-0.30	0.81	0.80	0.59	1					
Aust Small Caps	-0.39	-0.68	-0.35	0.75	0.74	0.59	0.93	1				
International Shares	-0.13	-0.47	-0.62	0.43	0.48	0.30	0.73	0.61	1			
Internat. Small Caps	-0.29	-0.43	-0.51	0.53	0.68	0.20	0.73	0.61	0.91	1		
Emerging Markets	-0.23	-0.75	-0.69	0.43	0.47	0.43	0.76	0.78	0.74	0.76	1	
Commodities	0.13	-0.08	-0.13	0.08	0.18	0.20	0.13	-0.04	0.31	0.38	0.24	1

Table 5: Historical returns around the world – "Small" and "Value" effect



Average annual return (%)	19.24	13.95	10.50	13.67	11.67	10.95	18.36	15.43	13.44	17.66	18.36	13.27	20.82	16.29	14.33
Average standard deviation (%)	27.56	23.62	24.06	27.21	20.69	21.99	35.05	31.08	34.30	24.60	28.61	22.70	39.24	35.47	34.96

direction of the market). Diversification across asset classes provides investors with the most diversification benefit.

Diversification within asset classes

This is achieved by ensuring a comprehensive spread of individual financial assets exists in an investment portfolio. Having more than one financial asset in an asset class or sub-asset class helps reduce the risk to the portfolio, if any one individual financial asset were to lose value. However, it should be recognised that diversification within an asset class does not eliminate systemic risk. For example, when the share market falls as it did in 2007-2009, most stocks fell together. Very few were able to buck the trend, irrespective of their intrinsic value.

Often, the best way to diversify within asset classes is to allocate capital to the known sub-asset classes and across a number of different stocks. Academic research on the behaviour of capital markets has strongly demonstrated the diversification and performance benefits of this practice.

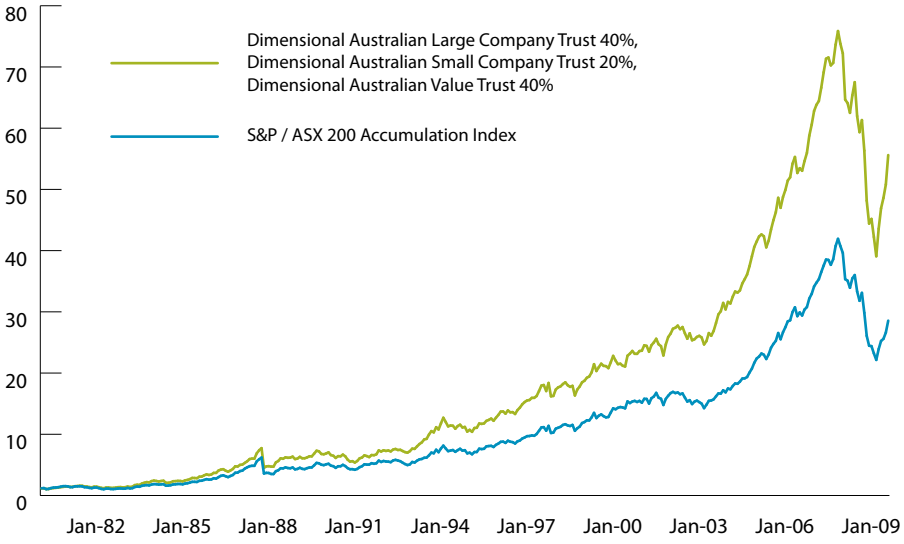
When constructing portfolios, we are therefore mindful that:

- Risk can be minimised by remaining invested over the long term
- Diversification (across and within asset classes) can be used to maximise return for a given level of risk, or minimise risk for a required level of return
- Undiversified portfolios expose themselves to risks that are not rewarded by the market
- Market timing strategies can detract value over the long term, particularly when costs and taxes are considered.

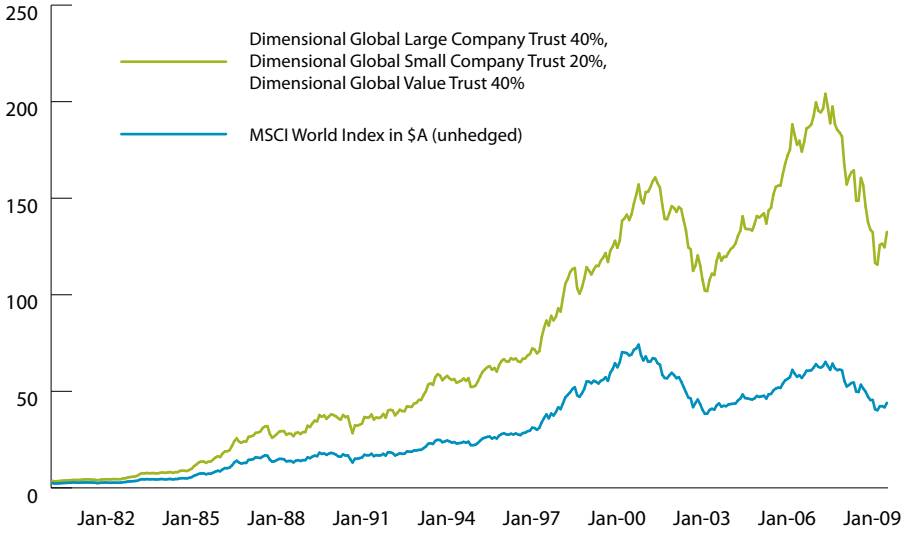
Importantly, by only capturing those risks worth taking in an investment portfolio, the investor can enjoy a reliable, consistent and superior return to most benchmarks and compared to other investors using less rigorous investment strategies.

Managing risk continued

***Graph 7: Risk & return are related** – the impact of size & price factors (Australian Equities) January 1980 – June 2009*



***Graph 8: Risk & return are related** – the impact of size & price factors (Global Equities) January 1980 – June 2009*



Exploiting Consistent Market Anomalies

Fama and French identified that there is reasonably consistent premium in small cap and value stocks. The 'small' and 'value' effect is consistent around the world. See Table 5.

Further, Graphs 7 and 8 for Australian and Global Equities compare the returns of a simple market index to an equity portfolio built using the investment philosophies discussed in this document.

By harnessing only those risks that have a reliable reward, investors benefit from a strong risk-adjusted performance that can significantly grow and maintain their real wealth over time.

This also mitigates any extra volatility in portfolios that would arise from non-systematic risks and delivers returns that surpass respective benchmarks.

PORTFOLIO REBALANCING

From time to time, investment portfolios move away from their strategic asset allocation benchmarks. This occurs because asset classes and sub-asset classes behave in different ways at different times. Their returns differ periodically (as intended), so the portfolio will skew in short to medium term time periods.

In order to deal with this phenomenon, portfolios need to be rebalanced back to their strategic benchmarks at an appropriate time, as the original benchmark is that which the investor agreed was appropriate for their long term tolerance of risk.

There are many approaches to portfolio rebalancing, but it is important to remember that when assets are bought and sold from portfolios costs and taxes are usually generated and these need to be factored into any rebalancing decision. Shadforth Financial Group has developed a policy on these principles that will be implemented on an ongoing process for you and your portfolio.

Rather than employing automated or rigid rebalancing policies on our client portfolios, we will generally rebalance from cash in an investor's portfolio. We do this by ensuring that the underlying assets distribute their earnings to a cash account, from which capital will then be available to top-up asset classes and sub-asset classes as the need arises.

This rebalancing will always be done with sensible tolerances for the natural movement in asset classes and sub-asset classes over time. This approach also helps manage portfolio costs and taxes, while allowing the capital markets to do their work for investors without significant interference.

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Summary

In our opinion, having a successful investment experience requires our clients to be 'Investors' rather than 'Speculators'.

Speculators are driven by short-term goals and the highest possible returns. They also tend to ignore the risk taken to earn that return. That is, the general result is the gamble that they either win or lose.

Often, speculators base their investment philosophies (where they exist) on a belief that in order to surpass the capital market rate of return, active strategies such as stock picking and market timing must be employed. Further, the pursuit of this objective means that costs and taxes are worthwhile casualties. Unfortunately, many of the strategies employed often end up underperforming a market benchmark over time, and not delivering even the capital market rate of return (which is available almost for free). This is even before costs and taxes are considered.

We believe the application of a speculator's philosophy therefore results in an ill-researched and unnecessarily costly investment portfolio, where the true level of risk is often hidden and is therefore impossible to manage. This is not an appropriate manner in which to apply investment capital.

Conversely, genuine investors understand the components and structures present in financial markets and the way in which they operate with each other. Investors will also tend to apply their capital using strategies that have academic validity and this will lead them to:

- Invest in known asset classes and sub-asset classes
- Adopt a long term strategic asset allocation consistent with their risk profile, with the full understanding of the potential extreme short-term downside risks that may be inherent within the asset classes
- Avoid predictions of future events and consequently, market timing strategies including tactical asset allocation
- Diversify as widely as possible, particularly across asset classes, ensuring complementary exposure to each asset class and sub-asset class
- Be mindful of costs and taxes that are implicit and explicit in their investment portfolio.

True investors appreciate the risk and return aspects of the whole portfolio and that of the individual building blocks in their portfolio. They appreciate that their portfolio is designed specifically to meet a set of pre-determined long-term goals, and that while the components of their portfolio may exhibit some price volatility in the short to medium-term, the capital markets price financial assets correctly over time and produce for investors a premium rate of return over inflation, over the long term.

In summary, our key investment beliefs are:

1. **Investing is Not Speculating** – Investors are entitled to their share of the capital market rate of return

on their assets over time and this is accomplished by exposing capital to the various available asset classes and sub-asset classes in expert fashion. Importantly, the return achieved from an asset class can take long periods to emerge. This is normal and efforts to short-cut normal long-term returns are speculative and often introduce unnecessary and unrewarded risks into the portfolio.

2. **Markets Work** – Prices for financial assets find equilibrium eventually and it is difficult to consistently predict and profit from any perceived inefficiencies in these prices. Importantly, the capital market rate of return is available to every investor at a reasonable price and the rate of return generated over the long-term has proved to be attractive.

3. **Risk and Return are Related** – Over the long term, the higher the risk, the higher the potential return. It is certainly possible to outperform markets, but only by accepting increased risk. Over short term horizons, however, risk and return can become disconnected, where high risk produces low returns. Not all risks are worth taking. Certain risk factors can be controlled to minimise risk and aid long-term return. Remaining invested is a key risk management tool.

4. **Diversification is Essential** – Concentrated, non-systematic risk is unrewarded in investment portfolios over time. Diversification is the antidote to many avoidable risks. Therefore, investment portfolios should be comprehensively diversified across and within asset classes and sub-asset classes.

5. **Portfolio Structure (Asset Allocation) Explains Performance** – The dominant contributor to portfolio performance is the relative exposure of capital to the various asset classes and sub-asset classes. Use of sensible strategic asset allocation, together with careful rebalancing, is likely to be more rewarding than speculative strategies such as market timing or tactical asset allocation.

6. **Costs and Taxes Matter** – Investment portfolios should be constructed and maintained with costs and taxes in mind. Costs and taxes may be implicit or explicit in an investment portfolio.

7. **Discipline is Paramount** – Investor behaviour is a major contributor to portfolio performance, both positive and negative. The media and the financial services industry tend to swamp investors with short term distractions and this can encourage unrewarded activity in portfolios. Numerous studies prove beyond doubt that investors can cause considerable harm to their portfolios by deviating from sound long term investment practices in the misplaced belief that short term market events can be managed.

Appendix A

ACADEMIC REFERENCES AND SOURCES & DESCRIPTIONS OF DATA

Enhanced Asset Class Investing is grounded on the findings of these key academic references and publications, abstracts for which are generally available on the internet. This list is not exhaustive.

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Appendix B

Inflation		
Inflation (CPI):	October 1948 - Present	Returns are restated after CPI for the quarter is released. Interpolated quarterly data into monthly data.
Cash		
Index - UBSWA 90 Day Bank Bill Index:	October 1989 - Present	UBS Warburg Australia 90 Day Bank Bill Index.
	February 1988 - Sept 1989	Warburg Dillon Read 90 Day Bank Bill Index.
	January 1977 - January 1988	90 Day Bank Bill Yields
Australian Fixed Interest		
Index - UBSWA Composite All Maturities:	November 1989 - Present	UBS Warburg Australia Composite All Maturities.
	April 1988 - October 1989	Warburg Dillon Read All Government Bond Index.
	February 1985 - March 1988	SSB Australian Bond Index.
Short Term Fixed Interest Strategy (Dimensional Short Term Fixed Interest Trust)	July 1999 - Present	Dimensional Short Term Fixed Interest Trust live returns, gross of fees & expenses. Actual monthly expenses adjusted back (most recent month is preliminary).
	October 1989 - June 1999	Warburg Dillon Read 90 Day Bank Bill Index.
	February 1988 - Sept 1989	Warburg Dillon Read 90Day Bank Bill Index.
	January 1977 - January 1988	90 Day Bank Bill Yields sourced from the Commonwealth Bank
Global Fixed Interest		
Index – Citigroup World Government Bond Index (AUD)	February 1985 - Present	Citigroup World Government Bond Index ex Australia. Hedged in AUD.
Diversified Fixed Interest Strategy (Dimensional Five Year Diversified Fixed Interest Trust)	October 2001 - Present	Dimensional Diversified Fixed Interest Trust live returns, gross of fees & expenses.
	December 1990 - September 2001	DFA Inc's 5 Year Global Income portfolio live returns, gross of fees & expenses, adjusted to simulate AUD hedged returns. Actual monthly expenses adjusted back (most recent month is preliminary).
	January 1989 – November 1990	Lehman hedged country indices equally weighted.
		(AUD hedged returns of the strategy were simulated using the DFA Inc's 5 Year Global Fixed Income Vehicle (portfolio), minus 1 Month US LIBOR returns plus 1 Month Australian BBSW returns courtesy of Bloomberg).
(Dimensional Two Year Diversified Fixed Interest Trust)	December 2005 – Present	Live returns from DFA Two-Year Diversified Fixed Interest Trust, gross of fees and expenses.
	March 1996 – November 2005	DFA Two Year Global Fixed Income Portfolio, gross of fees & expenses, adjusted to simulate AUD hedged returns.
Property		
Index – S&P/ASX 300 Listed Property Accumulation Index	June 1992 - Present	S&P/ASX 300 Listed Property Accumulation Index.
	January 1982 – May 1992	ASX All Ordinaries Property Accumulation Index.
Australian Equities		
Index - S&P/ASX 200 Accumulation Index:	April 2000 - Present	S&P/ASX 200 Accumulation Index
	June 1992 – March 2000	S&P/ASX 200 Accumulation Index (backfilled by S&P).
	January 1980 - May 1992	ASX All Ordinaries Accumulation Index.
Australian Large Company Strategy (Dimensional Australian Large Company Trust)	October 2000 – Present	Dimensional Australian Large Company Trust live returns, gross of fees & expenses. Actual monthly expenses adjusted back (most recent month is preliminary).
	June 1992 - September 2000	S&P/ASX 100 Accumulation Index.
	January 1991 - May 1992	ASX 100 Accumulation Index (Pre-Restructure).
	January 1980 - December 1990	ASX 50 Leaders Accumulation Index (Pre-Restructure).
Australian Small Company Strategy (Dimensional Australian Small Company Trust)	November 2000 - Present	Dimensional Australian Small Company Trust live returns, gross of fees and expenses.
	March 1995 - October 2000	S&P/ASX Small Ordinaries Index.
	January 1991 - February 1995	ASX Small Ordinaries Accumulation Index (Pre-Restructure).
	January 1980 - October 1990	ASX ex-50 Leaders Simulated Index sourced from John Nolan Associates.
Australian Value Strategy (Dimensional Australian Value Trust)	July 1999 - Present	Dimensional Australian Value Trust live returns, gross of fees & expenses.
	January 1995 - June 1999	Live Australian returns carved out from DFA Inc's Resident International Large Value and Small vehicles. Combined using market cap weights, gross of fees & expenses.
	January 1994 - December 1994	Live Australian returns carved out from DFA Inc's US Resident International Large Value Vehicle, gross of fees & expenses.
	January 1975 - December 1993	Strategy simulated by Fama/French based on data obtained from MSCI.

Global Equities						
Index - MSCI World Index (AUD)	January 1988 - Present	MSCI World Index, total return (net dividends) – Hedged				
Global Large Company Strategy (Dimensional Global Large Company Trust)	September 2000 - Present	Dimensional Global Large Company Trust live returns, gross of fees & expenses. Actual monthly expenses adjusted back (most recent month is preliminary).				
	July 1999 - August 2000	DFA Inc's US Large Company Vehicle live returns, gross of fees & expenses, plus DFA Inc's International Large Company Vehicle (portfolio) live returns, gross of fees & expenses, equally weighted-rebalanced monthly.				
	August 1991 - June 1999	DFA Inc's US Large Company Vehicle live returns, gross of fees & expenses, plus DFA Inc's International Large Company Vehicle (portfolio) live returns, gross of fees & expenses, combined based on market capitalization-rebalanced monthly.				
	January 1991 - July 1991	DFA Inc's US Large Company Vehicle (portfolio) live returns, gross of fees, plus MSCI EAFE Index, combined based on market capitalization-rebalanced monthly.				
	January 1975 - December 1990	S&P 500 returns plus MSCI EAFE Index, combined based on market capitalization-rebalance monthly.				
Global Small Company Strategy (Dimensional Global Small Company Trust)	September 2000 - Present	Dimensional Global Small Company Trust live returns, gross of fees & expenses. Actual monthly expenses adjusted back (most recent month is preliminary).				
	June 1988 – August 2000	Combination of regional small cap returns combined as described below-rebalanced monthly:				
		United States	**Japan**	**Continental**	**UK**	**Pacific Rim**
	January 1975 - August 2000	40.0%	21.0%	21.0%	9.0%	9.0%
	April 1998 - July 2000	40.0%	15.0%	24.0%	12.0%	9.0%
	April 1997 - March 1998	40.0%	18.0%	21.0%	9.0%	12.0%
	January 1995 - March 1997	40.0%	21.0%	21.0%	9.0%	9.0%
	January 1993 - December 1994	40.0%	21.0%	21.0%	9.0%	9.0%
	April 1990 - December 1992	40.0%	24.0%	21.0%	9.0%	6.0%
	October 1989 - March 1990	40.0%	24.0%	18.0%	12.0%	6.0%
	July 1988 - September 1989	40.0%	30.0%	18.0%	12.0%	0.0%
	January 1975 - June 1988	40.0%	30.0%	0.00%	30.0%	0.0%
	United States:					
	April 1992 - August 2000	DFA Inc's Small Company Vehicle (portfolio) live returns, gross of fees & expenses.				
	June 1996 - March 1992	DFA Inc's Small Company Vehicle (trust) live returns, gross of fees & expenses.				
	January 1975 - May 1986	CRSP 6-10 Index-Deciles 6-10, all exchanges (NYSE, AMEX and OTC)-rebalanced quarterly.				
	Japan:					
	April 1986 - August 2000	DFA Inc's Japanese Small Company Vehicle (portfolio), gross of fees & expenses.				
	January 1975 - March 1986	Japanese Small Company Index-Smaller half of Tokyo Stock Exchange 1st Section, Nomura Securities Investment Trust, Tokyo-rebalanced semiannually.				
	Continental:					
	July 1988 - August 2000	DFA Inc's Continental Small Company Vehicle (portfolio), gross of fees & expenses.				
	UK:					
	April 1986 - August 2000	DFA Inc's UK Small Company Vehicle (portfolio), gross of fees & expenses.				
	January1975 - March 1986	Hoare Govett Smaller Companies Index - London Business School.				
	Pacific Rim:					
	January 1993 - August 2000	DFA Inc's Pacific Rim Small Company Vehicle (portfolio), gross of fees & expenses.				
	October 1989 - December 1992	DFA Inc's Asia/Australia Small Company Vehicle (sub-trust), gross of fees & expenses.				
Global Value Strategy (Dimensional Global Value Trust)	September 1999 - Present	Dimensional Global Value Trust live returns, gross of fees & expenses.				
	July 1999 - August 1999	DFA Inc's US Large Value Vehicle, gross of fees & expenses, plus DFA Inc's International Large Value Vehicle, gross of fees & expenses, equally weighted.				
	July 1993 - June 1999	DFA Inc's US Large Value Vehicle, gross of fees & expenses, plus DFA Inc's International Large Value Vehicle. Based on MSCI Weights.				
	April 1993 - June 1993	DFA Inc's US Large Value Vehicle, gross of fees & expenses, plus International strategy simulated by Dimensional. Based on MSCI Weights.				
	January 1993 - March 1993	US strategy simulated by Fama/French com plus International strategy simulated by Dimensional. Based on MSCI Weights.				
	January 1975 - Dec 1992	US strategy simulated by Fama/French based on MSCI data. Combined based on MSCI weights.				
Emerging Markets Strategy (Dimensional Emerging Markets Trust)	October 2000 - Present	Dimensional Emerging Markets Trust live returns, gross of fees & expenses. Actual monthly expenses adjusted back (most recent month is preliminary).				
	May 1994 - September 2000	DFS Inc's Emerging Markets Vehicle open-end portfolio.				
	March 1993 - April 1994	DFS Inc's Emerging Markets Vehicle closed-end portfolio.				
	January 1988 - February 1993	Simulated index data.				

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