

**A parable for today's investor: Diversify and hold steady against doom-saying.**

Do you remember a time when these were typical financial headlines?

“Strongest One-Month Total Return for S & P 500 in Five Years”

“Dow Transportation Average Jumps 29%”

“Real Estate Securities Outperforming all Other DFA Equity Strategies”

Well, there's no need to feel nostalgic. These aren't stories from the halcyon days before foolhardy lending and speculation helped bring the economy to a near-standstill. They're adapted from overlooked financial news occurring right now – this year – even as economists debate whether we're in a recession.

Since a March 10 low for 2008, the S & P 500 has rebounded 11% (through May 2), with April the best month (4.87%) since December, 2003. Transportation stocks in the Dow, despite soaring fuel costs, have recovered to near record levels.

And on April 30, Dimensional Fund Advisors' real estate securities portfolio was outperforming its U.S. and non-U.S. equities with double-digit returns for year-to-date.

By the time you read this essay, these and dozens of other trends will again have migrated upward or down – perhaps even sharply. Yes, it is possible the stock market will fall further. Or not. And yes, many analysts see “prolonged pain” for the dollar and the economy. There's plenty of worry to go around.

So is now the time for a prudent, diversified investor to retreat – temporarily – from the market?

**Beware the prophets.**

We'd like you to meet William Miller: a kind of market analyst.

In the early 1800's, after years studying all of the available data (i.e., the Book of Daniel, Bishop Usher's timeline of creation), Miller deduced that The End would occur some time between March, 1843, and March, 1844.

Sincere and charismatic, he gained a small following. But when Miller's “end-time” elapsed harmlessly, he did something remarkable – undeterred, he simply checked his numbers and recalculated. And this time he set a specific date, October, 22, 1844. He circulated what these days we would call a prospectus, complete with his citations and methodology, and took to the Sunday lecture circuit.

Suddenly thousands responded to Miller's more-detailed vision, many of them well-to-do and influential. People sold their property, abandoned their families and careers ... readied themselves spiritually for the Second Coming.

As you know, the sun rose as usual October 23<sup>rd</sup>, 1844, and has continued to do so.

We mention this odd chapter in American history because it provides several exact parallels for today's investor in today's difficult stock market.

What historians (and psychologists) find so interesting is not Miller's prophecy. Apocalyptic timetables have been around for ages. What's telling is the fact that when he set a specific date his movement actually gained momentum – even though he'd been proven wrong only a few months earlier.

For purposes of divining the fate of today's stock market, let's call this the Law of Apocalyptic Vision.

**The more specific a market prediction,  
the more likely some will believe ... and act on it.**

Last year there were more than a handful of Millerites roaming Wall Street in the wake of the sub-prime mortgage fiasco.

In the aftermath of the meltdown, with millions of homeowners suddenly “upside-down,” stocks in a freefall, hundreds of mortgage companies out of business overnight, credit all but vanished, the Fed frantically slashing interest rates, hedge funds invoking lock-up policies to prevent runs on their capital, and securities firms laying off brokers ... a number of analysts and writers rushed into publication with speculations and now-embarrassing forecasts.

There were wild intimations of the dollar's “terminal decline” against the euro, or of China secretly liquidating its *entire* near \$1-trillion holding in T-bills ... thus triggering an “economic winter” in the United States.

And, as you'll recall, last fall analysts scrambled to be the first to predict calamitous declines in the Dow – 20, 30, 40% by year's end, take your pick.

*(Facts: the Dow finished 2007 up 6.43%; the broader S & P 500 finished 2007 up 3.53%.)*

Katrina or Bust

This is the same kind of instant doom-saying that followed Hurricane Katrina. Some analysts in the fall of 2005 predicted claims would top \$500 billion – and bankrupt many of the nation's property insurers.

For nightly television viewers of Gulf Coast devastation, half a trillion seemed a plausible number at the time. But in fact, claims were one-tenth of that, roughly \$50 billion. It was the largest single underwriting payout in history – but not one insurance company tanked.

More to our point, since Katrina the nation's top insurers have posted their two most profitable years. Ever.

The Dow also rises.

The sun did come up in 2008. And once again the stock market, albeit battered, has proven resilient.

No one predicted (nor could have) that less than a month after the shocking vaporization of one of the world's biggest investment banks – Bear Stearns – the Dow would rally nearly 1,000 points. But that is precisely what happened during one amazing week in April.

Which brings us to VIA IV's Law:

**Market predictions can only work in a vacuum – if no one is reacting to a current situation.**

**But, obviously, world markets are *constantly* reacting. Every hour of every day, markets are digesting and factoring new information.**

In other words, hundreds of thousands of people – executives, government officials, investors – are constantly working to alter the present. This is why “timing” the market is virtually impossible. And why picking winners and losers should be left to sportswriters.

**The key is smart diversification ... and staying put.**

Studies consistently show the only sure way to really *lose* money in the long term is trying to beat the market by jumping around between sectors and funds. Over the last two decades – through the peso crisis, the Asian and Russian collapses, 9/11 and innumerable other events – the stock market as a whole returned an average annual return of 11.8%. But a typical “active” investor, according Dalbar Financial Services data, netted annualized gains of only 4.3% after expenses.

Incredible. And there's more. An extensive new study by the Dartmouth economist who helped invent the Fama-French model (widely used to calculate risk-adjusted performance) says investors “collectively spend [i.e., waste] \$100 billion a year” trying to out-smart the market. Kenneth French took into consideration the expenses and typically high management fees of domestic equity funds.

At that price tag, “active investing is a negative-sum game,” wrote the New York Times. “Even if you have compelling reasons to believe a particular trade could beat the market, the odds are still probably against you.”

But stock pickers (and their clients) persist.

Already this year we are seeing moves back into the pummeled financial services sector. Why? Because some believe this group has bottomed out. Although the average international fund earned 16% last year, and emerging-market funds posted a 36% return, the Wall Street Journal reports some funds actually *trimming* their overseas holdings for moves into the domestic market – betting on the Big Bounce.

And some hedge funds are borrowing into that bet.

**Investing is not an act of faith.**

Sustained, *broadly-allocated* investing is the only rational approach to protecting one's financial future.

It's true that we live in an Analysts Culture where quarterly corporate earnings are forecast down to the decimal point – and to miss analysts' estimates, even by a penny, is to tempt punishment in the market.

But this is a far cry from Apocalypse.

What investors learned from the sub-prime fiasco is that 1) nothing happens in isolation and 2) world markets will correct. Just as the insurance industry swiftly reacted with improved risk modeling and underwriting after Katrina, world financial markets collectively will stabilize and prosper – as they always have – over time.

Precisely *when* will this occur? Exactly *where* on the planet? In *what* sectors? For the broadly diversified index investor, who is invested in almost everything everywhere, in terms of investment approach it doesn't matter.

Risk of Ruin?

What has all this meant to the well-allocated, long-term investor?

It certainly has provided some heart-pounding reading. Perhaps it was even cause for a long look out the kitchen window. (After all, no one is devoid of emotion!) But the well-diversified VIA IV investor – looking out that window – saw an undisturbed long-term horizon.

“Because our portfolios are so exceptionally diversified, and because I don't use potentially dangerous strategies like leverage, the risk of ruin in what I do is virtually non-existent,” says VIA IV, a family of proprietary “passive” index models.

“Only highly leveraged risk can take you to absolute zero. And what panicked the market about the sub-prime crisis was investors' suddenly realizing how highly leveraged many of these hedge funds are,” VIA IV said.

“Lack of knowledge creates fear. If you don't know what investments you're in, if you don't really understand them, when something like the sub-prime crisis comes along you'll be afraid ... and you probably should be.”

“For me, it's all about shedding light on the process ... making everything as transparent as possible,” he said.

“Time is your friend. And good investing is science, not hunches,” says VIA IV. “That's why I periodically rebalance every investor's portfolio ... to make sure the asset classes are always on target.”

VIA IV's Law – Part Two:

**“What stock pickers think will change tomorrow ... will probably change tomorrow.”**

“If your investment advisor can't explain the what, why, when and where of your investments to you ... to a point where you are comfortable no matter what happens short-term ... you probably don't have a good match,” said VIA IV.

**To learn more about VIA IV's investment philosophy, performance, allocation models and methodology, please go to [VIAIV.com](http://VIAIV.com).**

A coda:

William Miller spent the rest of his life apologizing for what followers called the “Great Disappointment.” But a few members of his radical movement got out of the “end-time” business and evolved into a mainstream denomination, the Seventh Day Adventists, known today for humanitarian aid in third-world countries.

Who could have predicted that?