

September 2008

A Letter on Current Events in the Markets

[David G. Booth](#), Chief Executive Officer, Dimensional Fund Advisors

Dear Client,

This has been a volatile week in global financial markets. I'm sure you don't need me to report the news to you, and I won't pretend I can predict how this downturn will stack up against ones we've seen before. No one knows how all this will play out. However, after talking with clients and having conversations with our investment team and the financial economists who consult to us, I want to offer two observations that I hope will be useful to you.

My first observation is that, while one hesitates to say that markets are "working" when they are so erratic, they are in fact doing exactly what they are supposed to do. We believe that markets are always moving toward equilibrium. For that to occur, prices have to be set, securities must be bought and sold, and trades need to clear. All of this is happening pretty smoothly around the world, despite the anguish sellers are feeling about sharply lower prices for many stocks.

Markets don't always get pricing right in the short run. That's the nature of risk. The table below displays three sets of returns for the S&P 500 Index and for Treasury bills, the "riskless" asset.

	S&P 500 Index	One-Month T-Bill
January 1965-December 1981	6.3%	6.7%
January 1982-December 1999	18.5%	6.2%
January 2000-September 18, 2008	-0.6%	3.1%

For the 17 years 1965-1981, the returns for both stocks and T-bills are about 6% per year. 1981 was Dimensional's first year. Financial markets were under stress, volatility was high and there was a general feeling of pessimism about equity markets since risk hadn't been rewarded for a long time. One financial magazine had as its cover story "The Death of Equities". Our view was that there was too much pessimism. There is no sensible risk/return story to explain why stocks should have a zero risk premium. There was no reason to get out of equities.

At the end of 1981, there were no articles saying that the next 18 years would be possibly the best 18-year period ever for US stocks. And yet that turned out to be the case. From 1982 to 1999, the S&P 500 had an 18% return per year, compared to 6% a year from Treasury bills. The attitude was the opposite of the 1981 viewpoint. People were too optimistic, in general. We think of S&P 500 stocks as having about a 10% cost of capital. When investors get 18% a year for S&P 500 stocks, they should enjoy it, but not count on it into the future.

The final line on the table displays the results for this millennium, a period of just under nine years. The return on the S&P 500 is almost flat. Once again, there is a lot of pessimism. Once again, we believe that pessimism might be overblown. Without making a forecast, we feel that a zero return for stocks is not the market-clearing expectation. We feel that clients should maintain their normal commitment to equities.

Which brings me to my second point: Because it's impossible to predict how markets will move at any time, diversification is critically important. Dimensional's investment approach results in portfolios that are broadly diversified and not concentrated in individual companies. As a result, although our funds' performance has been affected by declining stock prices, Dimensional isn't in the state of crisis that we hear other money managers may be experiencing right now. Our company is healthy.

Most of my personal wealth is invested in the markets through Dimensional funds, and I can understand the discomfort you are no doubt feeling as markets react to one headline after another. We deeply appreciate the confidence you have expressed in Dimensional by making us your investment manager, and will work hard to provide you with the information and resources you need during this challenging time.

Sincerely,

David Booth
Chairman and Chief Executive Officer