

Lowly Analyst Newsletter

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The Economy and the Market

Most markets declined for 3 months. What should you do? If you have a diversified portfolio, stay the course. After a large decline is not the time to sell stocks. If your portfolio is too risky, gradually reduce the risk over time. In the last 3 month the volatility has temporarily increased by 30%.

Nothing has fundamentally changed in the world economy in the last 3 months. The dollar remained stable. Foreign money is still flowing in. Technology is moving to developing countries. Hedge funds desperate for returns buy when relative strength (trend) is up and cover shorts. They try establishing short positions when the relative strength fades.

In client portfolios I continue to hold a diversified portfolio of institutional index funds because it has been shown that index funds perform better than actively managed funds and that asset allocation and diversification are the most important determiner of returns. I include REIT's and Natural Resources.

Asset Classes: For the 6 months, large-value up 5%, microcap 4%, mid value 2%, small value 1%, large growth -4%, mid growth, -6%, small growth -7%, micrcap -7%.

Sectors: For the 6 months, metal prices up 33%, indstrl commodity prices 24%, all commodities 13%, REIT's 11%, %, international real estate 11%, natural resources 2%, gold 12.

Foreign Investing: For the past 5 months to 7-26 Peru up 48%, China 30%, Venezuela 17%, Poland 15%, Russia 8%, Philippines 7%, Indonesia 7%, Britain 6%, Latin America 6%, Hong Kong 5%, Spain 4%, France 4%, Europe 4%, Australia 3%, Pacific Rim 3%, Netherlands 3%, Switzerland 3%, Malaysia 2%, Developed Countries 2%, Canada 1%, US 0%, Pacific Rim -3%, India -5%, Emerging Markets -6%,.

Best Foreign Developed Markets Large Cap Index Funds

1. Introduction

This is a continuation of discussion of index funds and ETF's that started in the June and July letters. In general, index funds perform better than actively managed funds over long periods of time. But no one investment is best for all people or at all times. You can not go wrong by investing in any of the funds mentioned here.

The construction of the underlying indexes differs widely leading to differences in performance. The funds are listed in approximate order of preference. Their long term performance is similar.

Below is a review of the characteristics of foreign large cap index securities for various situations. Investing internationally over the long run typically reduces portfolio volatility at a slight cost in returns. Currently it increases portfolio volatility and returns.

The funds of Dimensional Fund Advisors are the only pure sector funds. They meticulously stay by their definition of the sector. Their definition differs from that of others. They have no sector drift. DFA funds can be bought by institutions and through a few select advisors like myself.

2. Mutual Funds vs. ETF's

See the May letter.

3. Foreign Developed Markets Large Cap Index Funds

For each of the funds a number of measures are shown. Risk grade is a measure of volatility. A volatility of 20%, the average volatility of the markets of the world, has a risk grade of 100. The risk grade is an exponentially smoothed average over the last 151 days. The recent days count more. The risk grade of any security changes daily. It is a measure of the current risk.

Two other risk measures are provided. Bear market decile indicates how well the asset performed in bear markets; the lower the number, the better. The volatility is the 5 year

standard deviation; it measures the long term risk. The Sharp ratio provides the ratio of return to volatility; the higher the better. The percentage of Large Cap or Value stocks as defined by Morningstar is shown.

4. Foreign Developed Markets Large Cap for Tax Deferred Accounts

There is little difference between the various options.

Vanguard Tax-Managed International Fund (VTMGX): Risk Grade 95, Bear Market Decile 4, Volatility 10%, Risk Return 1.88, Large Cap 88%, Expense 0.20%.

DFA Large Cap Intl Portfolio (DFALX) : Risk Grade 95, Bear Market Decile 4, Volatility 10%, Risk Return 1.84, Large Cap 85%, Expense 0.36%.

Vanguard Developed Market Index Fund (VDMIX) : Risk Grade 98, Bear Market Decile 4, Volatility 10%, Risk Return 1.88, Large Cap 87%, Expense 0.29%.

Fidelity Spartan Intl Index Fund (FSIIX): Risk Grade 98, Bear Market Decile 4, Volatility 10%, Risk Return 1.84, Large Cap 87%, Expense 0.10%.

T.Rowe Price Intl Equity Index Fund (PIEQX): Risk Grade 100, Bear Market Decile 4, Volatility 10%, Risk Return 1.86, Large Cap 88%, Expense 0.50%.

Dreyfus Intl Stock Index Fund (DIISX): Risk Grade 104, Bear Market Decile 4, Volatility 10%, Risk Return 1.85, Large Cap 87%, Expense 0.65%.

iShares MSCI EAFE Index Fund (EFA) Risk Grade 108, Bear Market Decile 4, Volatility 10%, Risk Return 1.88, Large Cap 88%, Expense 0.36%.

WisdomTree Intl Large Cap Dividend Fund (DOL): WisdomTree tracks the WisdomTree International Index. The index tracks the 300 largest firms weighted by the value of the dividends. ETF launched June 16, 2006. Bear Market Decile 4, Volatility 10%, Expense 0.55%.

BLDRS Developed Markets 100 ADR Index Fund (ADRD): Risk Grade 108, Bear Market Decile 4, Volatility 11%, Risk Return 1.54, Large Cap 100%, Expense 0.30%, Distr 2.9%.

5. Foreign Developed Markets Large Cap for Taxable Accounts

These funds usually have no large distributions. The funds are generally discussed above. Below are the distributions for the last 12 months.

Vanguard Tax-Managed International Fund (VTMGX): Distr. 2.5%.

DFA Large Cap Intl Portfolio (DFALX): Distr. 2.9%

Fidelity Spartan International Index Fund (FSIIX): Distr. 2.0%

Vanguard Developed Market Index Fund (VDMIX): Distr. 2.4%

T.Rowe Price Intl Stock Index Fund (PIEQX): Distr. 1.7%

Dreyfus Intl Stock Index Fund (DIISX): Distr. 2.0%

iShares MSCI EAFE Index Fund (EFA): Distr. 2.1%

6. Foreign Developed Markets Large Cap Value Funds for Tax-Deferred Accounts

Stocks are often divided into value and growth stocks. Contrary to what one may think, value stocks have in general higher volatility and higher return. Value stocks have low book to market value. In that sense they are bargains.

DFA Intl Value Portfolio (DFIVX): Risk Grade 103, Bear Market Decile 3, Volatility 11%, Risk Return 2.23, Lrg Cap Value %, Expense 0.44%.

Vanguard Intl. Value Fund (VTRIX): Risk Grade 100, Bear Market Decile 4, Volatility 12%, Risk Return 1.91, Lrg Cap Value 43%, Expense 0.50%.

iShares MSCI EAFE Value Index Fund (EVF): Risk Grade 108, Bear Market Decile 4, Volatility 12%, Risk Return 1.8, Expense 3.2 %.

WisdomTree Intl Dividend Top 100 Fund (DOO): The stocks are weighted by the value of the dividends. ETF launched June 16, 2006. Bear Market Decile 4, Volatility 12%, Expense 0.58%.

6. Foreign Dev Lrg Cap Value Funds for Taxable Accts.

These funds have usually no large distributions.
DFA Intl Value Portfolio (DFIVX): Distr. 5.2%
iShares MSCI EAFE Value Index Fund (EVF): Distr. 0.5%.