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About the Author



Preet Banerjee, B.Sc., FMA, DMS is a <u>financial advisor in Toronto</u> serving Canadians in Ontario and BC. Information on this site is for entertainment purposes ONLY. Always seek individual professional advice before making any financial decisions. (For information on securing Preet's professional services, you may visit his website for his <u>Toronto Financial Advisor</u> practice.)

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Dimensional Fund Advisors Part I

August 10th, 2008 • Related • Filed Under



Okay, so I know many people have been wondering about DFA (or Dimensional Fund Advisors). At the time of this writing, DFA's Enhanced Index Funds are ONLY available to investors who use one of the less than 100 financial advisors in Canada who are authorized to offer DFA funds to their clients. To put this in perspective, it is estimated that there are over 100,000 financial advisors in Canada - so basically only 0.1% of advisors can provide DFA funds to clients.

That in and of itself doesn't say much until you give it more context. I suppose a jaded person would just assume that advisors don't like it, hence no one really offers it. However, this is about as far from the truth as one can get. In my humble opinion, DFA is probably the pinnacle of prudent investing - but it requires an incredible set of leaps in beliefs and behaviours from the current state of affairs of investing in general.

Leap The First

For financial advisors - who are bombarded with product presentations and red carpet treatment from mutual fund companies, structured product groups and other money managers - the first leap is to set aside the roar of the active money management community and open one's mind to an alternative (passive investing). I suppose this 'leap' applies to investors as well, but they are more inclined to take this leap because there is no financial incentive for active investing over passive investing for investors (as there is with advisors). But DFA is not just a set of passive index products.

Leap The Second

For financial advisors and investors - the next leap is a commitment to education. On the surface, it would be very easy to dismiss DFA as simple indexing products like a benchmark tracking ETF or plain vanilla index mutual fund as mentioned before - but don't make the mistake of doing this. If you are serious about investing, take the time to learn what makes DFA different. I will attempt to provide all the information imparted to me by DFA while I was attending their conference - but there is a lot of material to digest. You may decide that DFA is not a right fit for you in the end, but I can almost guarantee you will have a better perspective of the markets and investing in general from what teachings they have to offer.

Some Interesting Points Before We Get Started

One of the portfolio managers is literally a former rocket scientist, having worked for General Dynamics in space shuttle related projects. Another Vice President has a Ph.D. in aeronautics. In fact, the board of directors and executive management team is littered with Ph.D.s in everything from theoretical physics, to applied mathematics and economics.

There are two Nobel Prize winners in Economics sitting on the board (there was a third, Merton Miller, but he passed away in 2000). The two current laureates are Myron Scholes and Robert Merton. Most people believe that another board member, Eugene Fama will receive the Nobel Prize in the future.

More on Eugune Fama - He's considered the father of Efficient Market Hypothesis. His Ph.D. thesis basically was the first time that anyone said that stock price movements are basically a random walk. This was in 1965. His work with Ken French is pretty much solely repsonsible for why you see the 3×3 Size and Style boxes on popular fund manager analytics like Morningstar and Globefund. (More on this later in the series.)

Two other members of the board of directors (David Booth and Rex Sinquefield) were the first two people to set up index funds (independently, although they knew each other) back the 1970's. Both were students of Fama at the University of Chicago (pretty the much THE hotbed of finance academics).

Their oldest fund has beaten it's benchmark by almost 2% on an after fee basis for the 25 years ending 2007. This means that after subtracting DFA's managment fee of 0.52% on this fund (a micro cap fund), it has still beaten it's benchmark (the Russell 2000). Note that normally there will be a 1.00% advisor fee added to this expense, but on the other hand to just replicate the Russell 2000 would require a small drag created by the plain vanilla index ETF as well.

DFA is the only fund company or investment product provider that interviews and assesses financial advisors based on their knowledge and business models (they only work with fee-based or fee-only advisors who they judge are able to understand what and how DFA funds work).

Even though there are very few advisors worldwide authorized to offer DFA funds, DFA has still managed to grow their assets under management to over \$150 billion. The institutional clients include the largest pension funds in the world, banks, and many university endowment funds.

Timothy Middleton wrote a good article on DFA which you can read by <u>clicking here</u>, if you are eager to learn more right away. But again, there is more to this story and I will do my best to really get you the nitty gritty details that I don't really see written anywhere. Stay tuned... it's going to take a while!

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Comment by Patrick on 11 August 2008:

Thanks for blogging this, Preet. This promises to be quite interesting!



Comment by Joe Dolan on 12 August 2008:

I still can't see the big mystery around dfa funds? If you have the capabilities to invest in etfs then what makes dfa funds so special?

I don't mean to be rude but just because someone has a phd in math means nothing? Look what happened to Long term capital management with Mervyn Scholes etc. They had to be bailed out by the us govt—lol.

DFA funds are missing the boat by making themselves so exclusive. Just my opinion. Preet, I hope that your next articles on dfa can convince me otherwise. Best regards—Joe



Comment by Joe Dolan on 12 August 2008:

DFA funds seem to be more trouble than they are worth.



Comment by Preet on 12 August 2008:

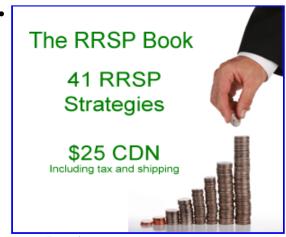
@ Joe - you may find very well determine that plain vanilla index tracking ETFs are good enough for you - and I don't think anyone would dispute that you will do better than most investors by doing just that. My goal is not to convince you that you must invest in DFA funds, but rather to educate people on them so that they can understand them better. Some people will choose to use them, others will not. I will discuss the differences between DFA funds and index ETFs in more detail later in the series.

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@ Michael James - very true, and you hit the nail on the head by using the term "businesses" instead

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■ @ Joe - you may find very well determine that plain vanilla index tracking ETFs are good enough for

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Hi Preet, I'm looking forward to the rest of your DFA series. I agree with you that mispricings occur infrequently ...

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Thanks for blogging this, Preet. This promises to be quite interesting!

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Melissa - thanks for your interest, but unfortunately the July contest is over - the next one will be

... D--

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Of the choices remaining, I've only seen the original Ocean's Eleven. It's a stylish film that inspired the remake. Please ...

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@ Joe - thanks for the compliment - cheque is in the mail! :) As you will probably notice shortly, I ... Preet | 10Aug08 | More

Congratulations Preet and thanks for the plug as well. I've added my vote. A more permanent link to the story ...

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