

7.40	66.10	31.39	21.43
3.90	56.22	26.66	15.99
0.39	46.33	22.59	11.90
-1.09	36.12	18.58	9.86

# Cedarwinds Quarterly

Performance Updates and Market Commentary for Long-Term Investors

Vol. 2 Q2-06 (i)

## Asset Class Returns\*

	Annualized Returns**			
	3/31/06 YTD	1 Year	3 Years	5 Years
<b>Bonds</b>				
Short-Term	0.99	2.30	1.60	2.88
Two-Year	0.75	1.90	1.51	3.16
Five-Year	0.74	0.77	2.06	4.93
Intermediate	0.00	1.72	2.53	4.73
<b>U.S. Stocks</b>				
Large Market	4.21	4.85	14.25	0.39
Large Value	6.20	10.24	20.56	9.14
Small Micro	14.39	5.69	26.22	16.45
Small Value	15.06	7.79	29.16	19.11
Real Estate	15.40	13.15	26.54	19.02
<b>Int'l Stocks</b>				
Int'l Large Value	12.35	15.27	30.57	11.53
Int'l Small	11.13	21.96	36.35	18.09
Int'l Small Value	12.68	23.23	40.37	22.62
Emg Mkts	10.67	29.86	39.29	17.81
Emg Mkts Value	13.69	30.81	47.61	25.51
Emg Mkts Small	12.83	25.75	40.96	21.94
Continental Small	19.92	18.40	36.18	18.19
Japanese Small	2.26	38.29	41.11	18.53
Asia Pacific Small	13.72	8.00	30.44	18.65
UK Small	11.02	12.63	29.76	12.60

## Description of Index Funds

Short-Term Bonds	DFA 1-Year Fixed Fund
Two-Year Bonds	DFA 2-Year Global Fixed Fund
Five-Year Bonds	DFA 5-Year Government Fund
Intermediate Bonds	DFA 5-Year Global Fixed Fund
Large Market	DFA Large Company Fund
Large Value	DFA US Large Value Fund
Small Micro	DFA US Micro Cap Fund
Small Value	DFA US Small Value Fund
Real Estate	DFA Real Estate Fund
Int'l Large Value	DFA International Value Fund
Int'l Small	DFA International Small Fund
Int'l Small Value	DFA International Small Value Fund
Emg Mkts	DFA Emerging Markets Fund
Emg Mkts Value	DFA Emerging Markets Value Fund
Emg Mkts Small	DFA Emerging Markets Small Fund
Continental Small	Continental Small Company
Japanese Small	Japanese Small Company
Asia Pacific Small	Asia Pacific Small Company
UK Small	United Kingdom Small Company

\*Source: Dimensional Fund Advisors ([www.dfaus.com](http://www.dfaus.com))

The information contained herein is obtained from sources we believe are reliable, but we cannot guarantee its accuracy.

\*\* Calculated based on calendar year results.

Past performance does not guarantee future returns.

This newsletter is published by  
Cedarwinds Investment Management, LLC

4650 N. Port Washington Road

Milwaukee, WI 53212

Phone: (414) 431-7390

Fax: (414) 431-7396

Email: [info@cedarwinds.com](mailto:info@cedarwinds.com)

Website: [www.cedarwinds.com](http://www.cedarwinds.com)

Editor: Geoffrey G. Maclay, Jr.

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## THE 10 GREAT REASONS—REDUX

**Editor's Note:** *This is an update of the first edition of Cedarwinds Quarterly published in January 2005. It reflects the essence of our program.*

Cedarwinds was launched with the simple goal of creating the best set of investment solutions available anywhere to help individual and institutional clients meet their longer-term financial objectives.

To achieve this goal, a full range of portfolio solutions has been constructed using a strategic blend of high-performance, reduced-risk, low-cost index funds. One of the most important elements of our marketing strategy involves educating our target audience regarding the compelling benefits of using our investment approach. We have organized these benefits into a summary list which we call "The 10 Great Reasons."

### 1. Simple, Disciplined Strategy

Our investment strategy is simple to understand. We focus on building wealth over the long run using the most effective investment technique available to accomplish this objective—strategic asset allocation. Our roster of model portfolios represents a comprehensive range of the highest risk-adjusted returns available using a strategic blend of globally-diversified asset classes. The disciplined, patient investment philosophy that we advocate avoids the seductive trap of trying to "beat" the market using short-term timing techniques, speculative stock picking or sector strategies. With our approach, there are no apologies that need to be made about investing in a particular asset class that may be out of favor. Instead, the real objective is determining how much risk-adjusted return our clients are seeking consistent with their investment goals and risk capacity.

### 2. Access to "Best-in-Class" Funds

Our strategic partnership with Dimensional Fund Advisors (DFA) allows us to provide clients with unique access to a full asset class range of high-performance index funds managed by the acknowledged global leader of structured index fund investing. DFA, which currently manages \$100 billion, has no retail offerings—you can't buy into their funds the way you would at Vanguard, Fidelity or any other retail fund company. Their award-winning funds are only available through a limited number of financial advisors like Cedarwinds that have met established standards for representing them in the investment marketplace.

### 3. Greater Returns, Lower Risks

Our structured index fund portfolios will *always* achieve greater risk-adjusted returns over time than any comparable actively managed investment style. The reason for this is due to investment management style drift and the intrinsically higher costs of active management versus our indexed approach. Since our portfolios are globally-diversified—representing positions in over 15,000 companies in 38 countries—we are able to offer more consistent portfolio returns at lower risk compared with active managers. Also, by carefully matching each client's risk capacity with

*Continued on back . . .*

portfolio risk exposure, we are able to provide the best chance of obtaining the long-term historical returns of the global markets that are most suitable to each investor. Our disciplined “buy, hold and rebalance” risk exposure strategy is the most effective way to capture those returns.

#### 4. Reduced Costs

Our portfolio approach results in minimization of investment management fees as contrasted to the high annual costs of running actively managed funds or the layered costs of “fund of funds” products. In fact, our model portfolio annual fund operating expenses average less than 40 basis points compared to the average cost of actively managed equity mutual funds of 150 basis points or more, depending on portfolio turnover and other hidden expenses.

#### 5. Lower Taxes

For taxable accounts, our approach minimizes taxes due to low portfolio turnover with the resulting benefit of reduced capital gains taxation. There are also a number of other specific tax-managed index fund strategies used to reduce taxes including:

- Avoid short-term gains
- Harvest capital losses
- Minimize dividend income
- Tax - lot accounting

#### 6. Compounding Wealth

Our approach results in vastly superior compounding of investment wealth. This is because we remain fully invested while also minimizing performance “leakage” due to our lower trading costs, smaller turnover expenses and reduced capital gains taxes compared with actively managed funds. In our formal client presentations, we offer a number of examples that quantify and graphically illustrate the differences in ending investment values of our indexed approach compared to actively managed alternatives. Our experience is that most investors typically have little appreciation for the incredibly erosive effect that costs have on performance and equity investment values over longer time periods.

#### 7. Efficient Portfolio Rebalancing

Our approach makes it easier to rebalance portfolios and maintain a consistent asset allocation over time, thus avoiding the style drift which typifies active portfolio management. This ensures portfolio integrity and helps performance predictability. Depending upon each client’s specific objectives, we generally employ two rebalancing techniques. First, we have the ability to automatically rebalance portfolios on a quarterly basis to preserve the integrity of the model portfolio baseline weighting. Our second approach is more flexible and involves a review of underlying asset class performance at the fund level with a

view to rebalance on a more periodic basis depending on tax considerations and client needs or preferences.

#### 8. Performance Consistency

We deliver reliable, consistent investment performance because we invest in asset classes that are engineered to mimic the returns of those asset classes. However, instead of matching an index that may somewhat arbitrarily represent an asset class, our portfolios strive to achieve the highest risk-adjusted returns for that asset class. As a result, while the DFA funds used in our portfolios may not look exactly like the best-known index for that asset class, they do reflect the purest representation of that asset class. This asset class purity is what drives the consistency of performance and therefore the relative predictability of our portfolio returns over time.

#### 9. Superior Performance Tracking

Our approach represents a much easier way to track relative investment performance because our portfolio returns can be efficiently compared to similarly weighted benchmark indices. This is in contrast to active management styles where valid, long-term benchmarking may be difficult or impossible due to hybrid or blended management styles, style drifting, shifting fund objectives, fund mergers, newness of the fund, and a host of other reasons.

#### 10. Reduced Stress

We frequently hear that the most important benefit of our indexed approach is that clients no longer experience the anxiety associated with all the daily business headlines and latest market hype. Our disciplined, objective investment process emphasizes understanding risk-return relationships and allows clients to invest without the stress levels that typically accompany active management investing. The fact is that investors generally make bad decisions under the pressure of trying to pick the right stock, when to buy or when to sell. Studies conclude time and again that investors tend to bail out of stock funds during downturns and buy back in too late after the markets have already recovered. Our proven strategy provides relief to investors who suffer from the emotional burdens of active management.

#### **The Ultimate Question**

After building our case with prospective investors regarding the benefits of our structured index fund approach, we always ask one final question: *“Why would you NOT invest with Cedarwinds?”* This allows us to assess the effectiveness of our story, clarify points made or respond to any objections that may arise. The answers are always interesting as they offer fertile areas for analysis in human behavior and investment psychology. We have addressed these responses in other editions of [Cedarwinds Quarterly](#) posted in the [Newsletter](#) section of our website ([www.cedarwinds.com](http://www.cedarwinds.com)).