

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 (iii)

## Asset Class % Returns\*

	5/31/06	Annualized Returns**		
	YTD	1 Year	3 Years	5 Years
<b>Bonds</b>				
Short-Term	1.74	2.30	1.60	2.88
Two-Year	1.57	1.90	1.51	3.16
Five-Year	1.42	0.77	2.06	4.93
Intermediate	0.69	1.72	2.53	4.73
<b>Domestic Stocks</b>				
Large Market	2.56	4.85	14.25	0.39
Large Value	7.17	10.24	20.56	9.14
Small Cap	7.92	6.08	23.73	11.53
Small Value	11.09	7.79	29.16	19.11
Micro Cap	7.21	5.69	26.22	16.45
Real Estate	7.72	13.15	26.54	19.02
<b>International Stocks</b>				
Intl Large Value	13.24	15.27	30.57	11.53
Intl Small	10.52	21.96	36.35	18.09
Intl Small Value	11.72	23.23	40.37	22.62
Emg Mkts	3.69	29.86	39.29	17.81
Emg Mkts Value	10.20	30.81	47.61	25.51
Emg Mkts Small	9.15	25.75	40.96	21.94
Continental Small	21.93	18.40	36.18	18.19
Japanese Small	-3.17	38.29	41.11	18.53
Asia Pacific Small	13.39	8.00	30.44	18.65
UK Small	14.17	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 Cap	DFA Small Cap Fund
Small Value	DFA US Small Value Fund
Micro Cap	DFA US Micro Cap Fund
Real Estate	DFA Real Estate Fund
Intl Large Value	DFA International Value Fund
Intl Small	DFA International Small Fund
Intl 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	DFA Continental Small Company Fund
Japanese Small	DFA Japanese Small Company Fund
Asia Pacific Small	DFA Asia Pacific Small Company Fund
UK Small	DFA United Kingdom Small Company Fund

\*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.

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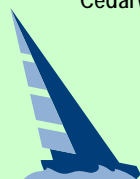
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## "WIZARD OF OZ" INVESTING: What's Really Behind the Green Curtain

*"Somewhere over the rainbow, skies are blue  
And the dreams that you dare to dream  
Really do come true ....*

*Somewhere over the rainbow, blue birds fly  
Birds fly over the rainbow  
Why then, oh why, can't I?"*

"Over the Rainbow" (The Wizard of Oz)

The view from the Yellow Brick Road looking out at the gleaming Emerald City in the distance is magical and seductive indeed. As Dorothy exclaims excitedly, "There's Emerald City. Oh, we're almost there at last, at last! It's beautiful, isn't it? Just like I knew it would be. He must be a wonderful Wizard to live in a city like that."



Once there, however, reality is very different. Toto tugs and pulls away a shiny green curtain that covers a small booth, revealing a white-haired, ordinary looking man who is furiously and frantically pulling levers, dials, and switches on an elaborate machine to control all the Wizard's special technological imaging effects.

**The Wizard** (*trying to cover up the curtain*): The Great Oz has spoken! Pay no attention to that man behind the curtain...the...Great...er...Oz has spoken!

**Dorothy** (*pulling aside the curtain and reprimanding*): Who are you?

**The Wizard** (*stuttering*): I...I...I am the Great and Powerful Wizard of Oz!

**Dorothy**: You are? I don't believe you!

**The Wizard**: I am afraid it's true. There's no other Wizard except me.

**Dorothy** (*scolding*): Oh, you're a very bad man!

**The Wizard** (*sadly*): Oh, no, my dear, I...I'm a very *good* man—I'm just a very bad Wizard.

Like Dorothy's pilgrimage to the Emerald City, the image that investors perceive from a distance often appears much more appealing than is actually the case when the real truth is discovered. The wizards of Wall Street really have no special powers. The investing public should not be duped by all the media hype and glitzy promotion geared to selling the image, not the substance.

*Continued on back . . .*

With this in mind, the following quotes are offered as a reality check on the current state of the investment environment.

### The Industry

"You don't need 99.9% of what Wall Street is selling. It's expensive, unsuitable or stupid. Most investments are designed to profit the brokers, bankers and insurance companies, not you. ...The only wizard that Wall Street resembles is the Wizard of Oz. ...The simple, low-cost investments are the ones that work. It just breaks my heart to see people involved with complicated, expensive things that I know will not perform well for them over time."

**Jane Bryant Quinn, Syndicated Columnist (2006)**

### Avoid Portfolio Complexity

"The basic building blocks for investor portfolios come from well-established, enduring marketplaces, not from some trendy concoctions promoted by Wall Street financial engineers. ...As a general rule of thumb, the more complexity that exists in a Wall Street creation, the faster and farther investors should run. Investors simply do not stand a chance competing in the market gains actively managed funds because their greed creates a conflict of interest that corrupts their behavior. You lose playing by their rules. ...The only way for the vast majority of investors to become successful investors is for them to avoid actively managed funds completely."

**David Swensen, Chief Investment Officer, Yale University (2005)**

### Minimize Costs

"As a group, investors never—**NEVER!**—enjoy the gross return that the markets deliver. Investors earn the net return, after all of the costs of our system of financial intermediation, so beating the stock and bond markets is zero-sum game before intermediation costs, and a loser's game thereafter."

**John Bogle, Founder, Vanguard Group, Inc. (2005)**

### Avoid Active Management

"Today, investors' frictional costs of all sorts may well amount to 20% of investment returns. The burden of paying stockbrokers, financial consultants and mutual fund managers cause investors to earn only 80% of what they would earn if they just sat still and listened to no one. Over the past 35 years, American business has delivered terrific results. It should therefore have been easy for investors to earn juicy returns; all they had to do was piggyback Corporate America in a diversified, low-expense way. An index fund that they never touched would have done the job. Instead many investors have had experiences ranging from mediocre to disastrous. ... Investors should remember that excitement and expenses are their enemies."

**Warren Buffet, Chairman, Berkshire Hathaway, Letter to Shareholders (2006)**

### Index Fund Advantages

"It's worse than I thought. Again and again in this column, I have argued that most stock mutual fund investors won't earn market-beating returns and that these folks would be better off buying market-tracking index funds. It turns out, however, that your chances of outpacing the stock market average are for slimmer than even I imagined. What's the problem? Most performance-hungry investors don't own just one actively managed fund. Rather they own a whole fistful of funds—and with every fund they add, the odds against them grow steeper. ...There's a good reason index funds fare so well and actively managed funds perform so poorly. It starts with the brutal math of investing which is principally about subtraction . . . costs, such as investment fund

expenses and trading costs. The odds of beating an indexing strategy would look even worse if you figure in taxes and investors' bad timing."

**Jonathan Clements, Wall Street Journal columnist (December 2005)**

### Investor Behavior and Mutual Fund Performance

"During the period of 1986-2005, the average annual return of the S&P 500 index was 11.9%. The return of the average investor in a stock mutual fund, however, was just 3.9% annually, representing a "lost opportunity" of 77%. Most investors are hamstrung by investment behavior that is counterproductive. Behavioral finance, as well as personal experience, has established that no other factor influences investor behavior more than aversion to loss. Most investor mistakes are made in attempting to avoid loss. Over the past 20 years, investors correctly guessed the direction of the market more than 75% of the time during rising markets but less than 50% of the time during falling markets."

**DALBAR Financial Services, Research Report (2006)**

### Hedge Fund Risks and Performance

"In 1985, approximately 40 hedge funds existed. In 2005, there were about 8,000. Currently, hedge funds manage about \$1 trillion in assets, roughly one-eighth of the amount managed by mutual funds. Some worry that investors in hedge funds do not fully understand the true returns or the risks they bear. Expenses are high. The management fee usually is 1% to 2% of assets and there is often a performance fee. This incentive fee is usually 20%, and is often structured to be paid only if cumulative returns exceed a threshold return, known as the "high-water mark." When cumulative returns fall below this mark, the general partner can close the fund, then start a new one in order to establish a new base mark for generating performance fees. This exit risk is often overlooked by investors. The average life of a hedge fund is only about 3 years."

**Financial Economists Roundtable (July 2005)**

"The majority of hedge funds have not provided their investors with returns which they could not have generated themselves by mechanically trading the S&P 500 Index."

**Research Report, Alternative Investment Research Center (2006)**

### Beware Product Proliferation

"The bottom line is this: The index community is at a crossroads. It's wandered so far from its roots of offering one-stop, broad-based exposure to the market that a return to that simpler approach may not be possible. In creating more complex offerings, the index community has found new revenue sources from hedge funds and other parties seeking very specialized tools, but it has done so at the risk of doing considerable harm to less sophisticated investors. ...Sadly, the celebration surrounding the rapid sales of several recent ETF launches seems eerily similar to the euphoria around fast selling Internet funds in the 1990s."

**Don Phillips, Managing Director, Morningstar (2006)**

### Summary

A part of Dorothy lives in the heart of every investor. We all would like to find that special place "over the rainbow" where dreams come true. But with investing, it is never wise to use hope as a substitute for the facts. The journey down the investment Yellow Brick Road is a risky one and demands objectivity. Discovering the truth requires us to pull back the green curtain and understand the reality behind the image.