INVESTMENT NEWSLETTER

"The important thing about an investment philosophy is that you have one you can stick with."
David Booth, Founder and Executive Chairman

E+R=O, A FORMULA FOR SUCCESS

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Dimensional Fund Advisors

Combining an enduring investment philosophy with a simple formula that helps maintain investment discipline can increase the odds of having a positive financial experience.

AN ENDURING INVESTMENT PHILOSOPHY

Investing is a long-term endeavor. Indeed, people will spend decades pursuing their financial goals. But being an investor can be complicated, challenging, frustrating, and sometimes frightening. This is exactly why, as David Booth says, it is important to have an investment philosophy you can stick with, one that can help you stay the course.

This simple idea highlights an important question: How can we, as investors, maintain discipline through bull markets, bear markets, political strife, economic instability, or whatever crisis du jour threatens progress towards our investment goals?

Over their lifetimes, investors face many decisions, prompted by events that are both within and outside their control. Without an enduring philosophy to inform their choices, they can potentially suffer unnecessary anxiety, leading to poor decisions and outcomes that are damaging to their long-term financial well-being.

When they don't get the results they want, many investors blame things outside their control. They might point the finger at the government, central banks, markets, or the economy. Unfortunately, the majority will not do the things that might be more beneficial— evaluating and reflecting on their own responses to events and taking responsibility for their decisions.

e+r=o[1]

Some people suggest that among the characteristics that separate highly successful people from the rest of us is a focus on influencing outcomes by controlling one's reactions to events, rather than the events themselves. This relationship can be described in the following formula:

e+r=o (Event + Response = Outcome)

Simply put, this means an outcome—either positive or negative—is the result of how you respond to an event, not just the result of the event itself. Of course, events are important and influence outcomes, but not exclusively. If this were the case, everyone would have the same outcome regardless of their response.

Let's think about this concept in a hypothetical investment context. Say a major political surprise, such as Brexit, causes a market to fall (event). In a panicked response, potentially fueled by gloomy media speculation of the resulting uncertainty, an investor sells some or all of his or her investment (response). Lacking a long-term perspective and reacting to the shortterm news, our investor misses out on the subsequent market recovery and suffers anxiety about when, or if, to get back in, leading to suboptimal investment returns (outcome).

To see the same hypothetical example from a different perspective, a surprise event causes markets to fall suddenly (e). Based on his or her understanding

Wealth Management

1 Jack Canfield, The Success Principles: How to Get from Where You Are to Where You Want to Be (New York: HarperCollins Publishers, 2004).

of the long-term nature of returns and the short-term nature of volatility spikes around news events, an investor is able to control his or her emotions (r) and maintain investment discipline, leading to a higher chance of a successful long-term outcome (o).

This example reveals why having an investment philosophy is so important. By understanding how markets work and maintaining a long-term perspective on past events, investors can focus on ensuring that their responses to events are consistent with their long-term plan.

THE FOUNDATION OF AN ENDURING PHILOSOPHY

An enduring investment philosophy is built on solid principles backed by decades of empirical academic evidence. Examples of such principles might be: trusting that prices are set to provide a fair expected return; recognizing the difference between investing and speculating; relying on the power of diversification to manage risk and increase the reliability of outcomes; and benchmarking your progress against your own realistic long-term investment goals.

Combined, these principles might help us react better to market events, even when those events are globally significant or when, as some might suggest, a paradigm shift has occurred, leading to claims that "it's different this time." Adhering to these principles can also help investors resist the siren calls of new investment fads or worse, outright scams.

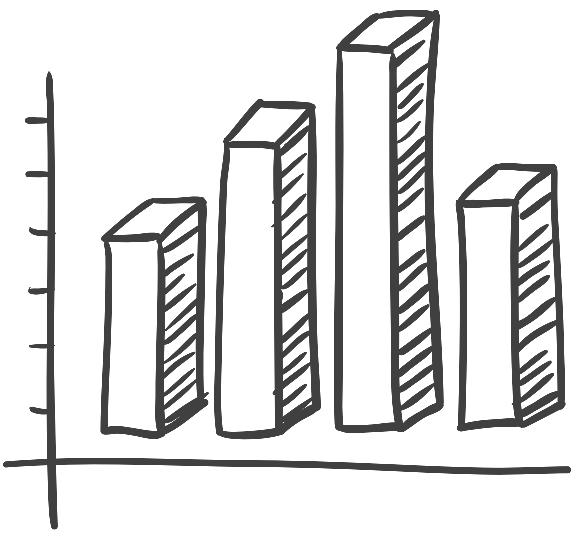
THE GUIDING HAND OF A TRUSTED ADVISOR

Without education and training—sometimes gained from bitter experience—it is hard for non-investment professionals to develop a cogent investment philosophy. And, as we have observed, even the most self-aware find it hard to manage their own responses to events. This is why a financial advisor can be so valuable—by providing the foundation of an investment philosophy and acting as an experienced counselor when responding to events.

Dimensional has an enduring investment philosophy that is shared by the advisors we work with and is the foundation for how we view the world of investing. We trust in the power of markets to deliver reliable returns over time and focus our efforts on helping investors benefit from as much of the return of the market as possible.

We know that investing will always be both alluring and scary at times, but a view of how to approach investing combined with the guidance of a professional advisor can help people stay the course through challenging times. Advisors can provide an objective view and help investors separate emotions from investment decisions. Moreover, great advisors can educate, communicate, set realistic financial goals, and help their clients deal with their responses even to the most extreme market events.

In the spirit of the e+r=o formula, good advice, driven by a sound philosophy, can help increase the probability of having a successful financial outcome.



Source: Dimensional Fund Advisors LP.

Past performance is no guarantee of future results. There is no guarantee investment strategies will be successful. Investing involves risks including possible loss of principal. Investors should talk to their financial advisor prior to making any investment decision. There is always the risk that an investor may lose money. A long-term investment approach cannot guarantee a profit. Dimensional Fund Advisors LP ("Dimensional") is an investment advisor registered with the Securities and Exchange Commission. All expressions of opinion are subject to change without notice in reaction to shifting market conditions. This content is distributed for informational purposes, and it is not to be construed as an offer, solicitation, recommendation or endorsement of any particular security, products, or services.

SAILING WITH THE TIDES

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Embarking on a financial plan is like sailing around the world. The voyage won't always go to plan, and there'll be rough seas. But the odds of reaching your destination increase greatly if you are prepared, flexible, patient, and well-advised.

A mistake many inexperienced sailors make is not having a plan at all. They embark without a clear sense of their destination. And once they do decide, they often find themselves lost at sea in the wrong boat with inadequate provisions.

Likewise, in planning an investment journey, you need to decide on your goal. A first step might be to consider whether the goal is realistic and achievable. For instance, while you may long to retire in the south of France, you may not be prepared to sacrifice your needs today to satisfy that distant desire.

Once you are set on a realistic destination, you need to ensure you have the right portfolio to get you there. Have you planned for multiple contingencies? What degree of "bad weather" can your plan withstand along the way?

Key to a successful voyage is a good navigator. A trusted advisor is like that, regularly taking coordinates and making adjustments, if necessary. If your circumstances change, the advisor may suggest you replot your course.

As with the weather at sea, markets can be unpredictable. A sudden squall can whip up waves of volatility, tides can shift, and strong currents can threaten to blow you off course. Like a seasoned sailor, an experienced advisor will work with the conditions.

Once the storm passes, you can pick up speed again. Just as a sturdy vessel will help you withstand most conditions at sea, a well-diversified portfolio can act as a bulwark against the sometimes tempestuous conditions in markets.

Circumnavigating the globe is not exciting every day. Patience is required with local customs and paperwork as you pull into different ports. Likewise, a lack of attention to costs and taxes is the enemy of many a long-term financial plan.

Distractions can also send investors, like sailors, off course. In the face of "hot" investment trends, it takes discipline not to veer from your chosen plan. Like the sirens of Greek mythology, media pundits can also be diverting, tempting you to change tack and act on news that is already priced in to markets.

A lack of flexibility is another impediment to a successful investment journey. If it doesn't look as though you'll make your destination in time, you may have to extend your voyage, take a different route to get there, or even moderate your goal.

The important point is that you become comfortable with the idea that uncertainty is inherent to the investment journey, just as it is with any sea voyage. That is why preparation and planning are so critical. While you can't control every outcome, you can be prepared for the range of possibilities and understand that you have clear choices if things don't go according to plan.

Source: Dimensional Fund Advisors LP.
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DOING WELL AND DOING GOOD?

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Growing interest in the impact of fossil fuels on the global climate may spark questions about whether individuals can integrate their values around sustainability with their investment goals and, if so, how.

As citizens, individuals can express their political preferences around sustainability through the ballot box. As investors, they also can express their preferences through participation in global capital markets. One key question these investors face is how to do this without compromising their desired investment outcomes. For instance, how can they reduce their portfolio's environmental footprint while maintaining sound investment principles and achieving their investment objectives?

Sustainability preferences are not generally restricted to greenhouse gas emissions. Many investors may also have concerns about land use and biodiversity, toxic spills and releases, operational waste, and water management, among other issues. Thus, it is a challenge to achieve the dual goal of efficiently considering sustainability preferences while building investment solutions that help meet investors' financial goals. One way to approach this challenge is to focus first on developing an investment methodology that emphasizes what research indicates are reliable sources of higher expected returns while also aiming to minimize unnecessary turnover and trading costs. For instance, this may mean starting with a broad universe of stocks ranging from very large companies to very small companies, and then systematically pursuing higher expected returns by increasing the weights of those securities with smaller market capitalizations, lower relative prices, and higher profitability.[1]

Next, investors can evaluate those companies being considered for investment using a focused set of environmental issues that reflect their primary concerns. By using a holistic scoring system, rather than a completely binary "in" or "out" screening process, investors may be able to preserve diversification while recognizing those companies with positive environmental profiles. This involves looking at companies across the entirety of a portfolio and within individual sectors with the goal of incorporating sustainability preferences while also maintaining the characteristics of the original strategy. For example, if one is trying to reduce a portfolio's greenhouse gas emissions and potential emissions from fossil fuel reserves, the worst offenders across all industries may first be deemphasized or excluded from the portfolio altogether. An across-industry comparison of this nature provides an efficient way to significantly reduce the aggregate greenhouse gas emissions per unit of revenue produced by companies within a portfolio with a minimal reduction in diversification. Next, companies may also be rated on sustainability considerations within each industry.

This added level of scrutiny is recognition that, in the real economy, capital markets and the supply chain are highly interconnected. For example, a retail company may consume electricity from a utility company and transportation services from a trucking company, both of which are consumers of fuel from an energy company.

Comparing companies within sectors recognizes this interconnectedness and can be used to overweight the most sustainable companies within a given industry. This could include retail companies that improve the energy efficiency of their facilities, utilities that produce electricity using solar or wind power, trucking companies that improve the fuel efficiency of their fleets or use alternative-fuel vehicles, or energy companies that increase efficiency, reduce waste, and improve their overall environmental footprint. On the other hand, companies with poor environmental sustainability ratings relative to industry peers may receive a lesser weight or may be excluded.

Using such a combination of company selection and weighting may allow for substantial reduction in exposure to greenhouse gas emissions and potential emissions from fossil fuel reserves—important goals for many investors—while providing a robust investment strategy that is broadly diversified and focused on the drivers of expected returns.

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1 Profitability is measured as operating income before depreciation and amortization minus interest expense scaled by book equity.

CONCLUSION

The key takeaway for investors is that investing well and incorporating values around sustainability need not be mutually exclusive. By starting with a robust investment framework, then overlaying the considerations that represent the views of sustainability-minded investors, this allows for a cost-effective approach that provides investors the ability to pursue their sustainability goals without compromising on sound investment principles or accepting lower expected returns.

A SUGGESTED APPROACH TO SUSTAINABILITY INVESTING

1	Apply a methodology that emphasizes the sources of higher expected returns while minimizing unnecessary turnover and trading costs.
2	Systematically evaluate company sustainability metrics across all major industries.
3	Emphasize investment in companies acting in more environmentally sound ways than their industry counterparts.
4	Exclude or underweight companies based on other key environmental and social considerations while maintaining broad diversification.

Source: Dimensional Fund Advisors LP.
Diversification does not eliminate the risk of market loss. There is no guarantee an investing strategy will be successful. Investment risks include loss of principal and fluctuating value. Sector-specific investments can also increase these risks. Environmental and social screens may limit investment opportunities.

Small and micro cap securities are subject to greater volatility than those in other asset categories.
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