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Structured asset management programs might be best bet for investments

INSIDER'S VIEW

Philip Henry

You've heard or seen the ads: "We're bigger, we're stronger, we're older, we're more experienced, we have more integrity, etc."

I am referring, of course, to investment management firms. These ads typically tout, and are the drumbeat of, active money managers. Using their wisdom, systems, processes and people, the implication is that they regularly and routinely outperform the market.

How? Through superior stock selection and tremendous market timing, of course. I refer to this active style of managing assets as the "Wall Street Research Model," despite the fact that not all firms embracing this style are located on that hallowed stretch of pavement.

There are a number of active investment managers that actually do outperform their comparative benchmarks in a given year. Few, however, seem to be able to beat their targets consistently, year after year. Identifying past success stories is the easy part. Banking on their continued success or even identifying new stars in advance is what's difficult.

PASSIVE MANAGERS

Converse to active managers are passive money managers. Their mantra is "capital markets work efficiently and produce returns to which investors are entitled."

Passive portfolios tend to be less risky than active portfolios, as they typically contain more holdings and thus, are more diversified than competing active portfolios.

If a passive index, such as the S&P 500, a benchmark for large-cap domestic portfolios, has the capacity to outperform many active managers, with lower portfolio risk, why don't investors simply own passively managed indices, unsubscribe from Money Magazine and go to the gym or take a nap with their newly found free time?

Frankly, many have indeed chosen this passive route. One of the largest mutual funds in the world is the Vanguard 500 Index, a passive indexing strategy designed to track the S&P 500, which speaks to this trend.

POP RISK QUIZ

Why is minimizing risk an important aspect of portfolio management? An elementary quiz may drive home the point. Start with $100,000, using your money, of course. Gain 100 percent in year one, then lose 50 percent in year two. Before answering, try the reverse- lose 50 percent in year one but then rebound with a 100 percent gain in year two. How'd you do? Break even is the correct answer.

A NEWER ARENA

In 1973, a new investment arena of sorts was built, when Rex Sinquefield, working for American National Bank at the time, first proposed the concept of an "index fund" to mimic the characteristics of the S&P 500.

Sinquefield wasn't through conceiving new ideas or new arenas, however. In 1981, he teamed up with David Booth to create Dimensional Fund Advisors. Both had studied together at the University of Chicago's Graduate School of Business and were joined by some highly regarded academicians.

DFA's breakthrough was to start with an entire universe of securities representing a passive asset class. By applying academically derived screens, their process filters out holdings for a variety of reasons. Some reasons to exclude a security? Examples include low liquidity, no earnings, initial public offerings or companies in bankruptcy. This investment arena, referred to as structured money management, is what I refer to as the "Academic Research Model."

Pioneered by DFA, structured management is becoming increasing more popular and mainstream. Consider that DFA alone now manages more than $100 billion in assets for some of the largest institutions in the country.

Locally, PPG Industries, Carnegie Mellon University and The Western Pennsylvania Teamsters and Employers Pension are direct clients of DFA. Responding to demand from independent financial planners, DFA does allow select Registered Investment Advisory firms to access their funds for their clients, but only those who have completed a rigorous due diligence process.

Investors looking to consider a new arena for their portfolios might do well to consider the merits of a structured asset management program.

PHILIP HENRY, president of Henry Wealth Management LLC, may be contacted at Phil@HenryWealth.com.