ROCKWOOD WEALTH MANAGEMENT

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Inside:

Rockwood Wealth Management

Offices

Maryland
200 Harry S. Truman Pkwy., Ste. 300
Annapolis, MD 21401

Pennsylvania
362 West Bridge St.
New Hope, PA 18938

Principals

Brian Booth, CFP®
Ted Toal, CFP®
John Augenblick, MBA, CFP®

Contact Information

Phone: **267-983-6400**
Fax: **888-753-8777**

Website:
www.RockwoodWealth.com

Email:
info@RockwoodWealth.com

WITH IRREFUTABLE CERTAINTY

The market downturn and our journey towards subsequent recovery have reaffirmed something that clients of Rockwood Wealth Management already know to be true: Making substantive changes to a well-engineered portfolio when one's deeply held goals and core values have not changed is the behavior of the unintelligent investor.

Accordingly, there is a fantastic recent study from renowned behavioral economists Richard Thaler and Shlomo Bernartzi that scientifically demonstrated that the more often people looked at their portfolios, the lower their actual returns were. This finding, while unfortunate for those sprinting to the mailbox to grab those monthly statements or refreshing their online accounts like 15-year-olds with Facebook profiles, makes perfect sense. The more frequently that poorly advised investors examine their holdings, the more likely they are to replace an asset class that appears to be lagging (read: historically lagged) with one that has already risen.

With irrefutable certainty, we know that sophisticated planning and investment behavior management will forever trump "the perfect portfolio" or some sequence of inane market timing attempts. We routinely meet prospective clients who have recently and repeatedly made dreadful and wealth-crippling investment mistakes, despite having portfolios full of only "5-star" funds. They have continually bought the wrong asset classes at the wrong time because they have operated emotionally and made decisions outside the context of a comprehensive plan for their financial lives. They perhaps were not privy to the beautiful truth, which follows:

- Investors who view their investment portfolios as simply a tool of the comprehensive plan for the attainment of their long-term goals are unlikely to make behavioral mistakes.
- Investors with written investment policy statements are unlikely to make behavioral mistakes.
- Investors who ignore the financial media and reject the fantasy that is the timing and selection culture are unlikely to make behavioral mistakes.

It stands to reason, then, that since Rockwood Wealth clients have intuited all three tenets of the beautiful truth, they earn the rates of return to which they are entitled during market volatility. Pat yourself on the back, because that is exactly what has occurred during the market recovery of 2009.

Inconspicuous Diligence

At the risk of diminishing the emphasis that we have so passionately placed upon mastering behavioral issues and sophisticated financial planning, we want to revisit the mind-set that Rockwood uses to select the tools necessary to implement your strategic investment plan. Caution must be given here, as there exists a tendency for all of us to place undue focus on the investments themselves instead of on the plan for effective wealth management. Nonetheless, it is crucial to continue to communicate how your best interests are preserved during the execution of your strategic investment plan.

Our mantra has always been that the optimal methodology for implementing an investment plan is to access the correct asset classes, in the correct proportions, in a manner that is low-cost, tax-efficient, and scientifically diversified. Though we publicize this mind-set as often as we can, it is always helpful to look at real-life empirical evidence to put some numbers behind the philosophy.

We thought a "blind taste test" of sorts would serve as the most effective tool for meeting our goal of providing continuing education for our clients. Let's see how sophisticated your palate is.

> Which of these funds are the two most popular international stock funds on the planet (neither of which is found in Rockwood portfolios), and which one does Rockwood Wealth Management use to gain requisite exposure for our clients in international markets?

Fund Characteristic	International Stock Fund "A"	International Stock Fund "B"	International Stock Fund "C"
Current Morningstar rating (5-stars is the highest rating)	**4-stars**	**5-stars**	**3-stars**
Number of stocks in the fund	**324**	**280**	**4,130**
% of assets actually invested in non-US stocks	**<90%**	**<89%**	**>99%**
Annual turnover of stocks inside the fund	**49%**	**41%**	**2%**
Number of countries in the portfolio	**18**	**16**	**40**
% invested in small non-US stocks	**<1%**	**0%**	**11%**
Annual expenses and taxes for an investor in the 35% federal bracket per $1,000,000 invested	**$18,300**	**$23,600**	**$8,400**
Return this year through Aug-31	**21.8%**	**27.4%**	**36.4%**

Sources: Morningstar.com, Personalfund.com

You might not be surprised that the following funds correspond to the ones listed in the table from the previous page.

Fund A	**Fidelity Diversified International Fund (second largest international stock fund)**
Fund B	**American Funds Euro-Pacific Growth Fund (largest international stock fund)**
Fund C	**DFA ex-US Core Equity Fund (found in Rockwood portfolios)***

*Note: Some Rockwood client accounts hold DFA International Core Equity and Emerging Markets Core Equity to achieve the essentially identical holdings of the DFA ex-US Core Equity fund.

Please make sure that you understand very clearly that this demonstration is not an "I told you so" moment. We are not saying that Funds A and B are bad mutual funds. **We are certainly not saying that we are able to identify in advance which mutual funds will outperform others; that is the claim of charlatans.** In fact, the least important field in the table on the preceding page is the year-to-date return. We are, however, stating that *you* will outperform most others, since you and your portfolio have the structure and the discipline necessary to earn the rates of return that others chase when they buy 5-star funds after they've already gone up and sell them when they become 2-star funds.

We think it is further enlightening to look at the holdings as they compare to the names of these popular retail funds and examine how the nomenclature is simply part of the marketing strategy. In Fund A, the name "Diversified International Fund" implies that you are purchasing a mutual fund that holds international stocks in a diversified manner. It might be surprising, then, to learn that 10% of the fund's holdings are something other than international stocks. You would also expect, as the name implies, a diversified fund. So why are there only 324 stocks instead of more than 4,100? Why 18 countries instead of 40?

Of further note, roughly half of those supposedly "great" 324 stocks were all of a sudden deemed "not so great" and sold during the past 12 months. Those sales were accompanied by the resultant taxes and trading costs that flowed through to the investors in the fund. Forgive us if we cannot see the logic in holding mutual funds that operate in this manner.

The name of Fund B, the Euro-Pacific Growth Fund, insinuates that you are purchasing a fund that holds growth stocks in European and Pacific Rim countries. Amazingly, 11% of this fund is invested in something other than stocks—in this case, in cash and bonds. Moreover, less than 75% of the fund's assets are invested in European and Pacific Rim stocks (two of its top 10 holdings are in Latin America). Though "growth" appears in the name, the holdings are actually a large blend more so than large growth stocks. Staggeringly, its expenses are nearly *three times* those of institutional Fund C's, and it holds effectively zero small-cap and micro-cap international stocks. And yes, we cannot help but laugh to ourselves a bit when we see that the Morningstar rating is still 5 stars.

We do not want the point we are making to get lost in the granularity of the details we have presented here. What is salient is that we know that in order to allocate your assets in your best interests, we must adhere to the academically vetted process of accessing markets in low-cost, tax-efficient, and scientifically diversified vehicles. It will never be glamorous, it will never be thrilling, and it will definitely never be on CNBC. However, our inconspicuous diligence will ensure that your assets are properly aligned with your most deeply held goals.