"The distribution [of the market] is fat-tailed relative to the normal distribution…For passive investors, none of this matters, beyond being aware that outlier returns are more common than would be expected if return distributions were normal."

— Eugene Fama - Professor of Finance, University of Chicago Booth School of Business, "Q&A: Confidence in the Bell Curve," March 2009

Black Swans, Fat Tails and Your Money

On May 6th, 2010, the stock market suffered the worst one-trading day plunge in history as it dropped almost 1,000 points in less than a half hour. If you were watching CNBC, you would have thought we had been attacked by terrorists. People were screaming at the top of their lungs in the background, and the TV guests' voices were fluctuating as though they had just seen a ghost.

This is what some people would call a black swan and these extreme events are expected in distributions that are known to have fat tails, like stock market returns. Black Swan events are described by Nassim Nicholas Taleb in his 2007 book, The Black Swan. The main idea Taleb seeks to drive home is that it is foolish to try to predict Black Swan events and that those events can have a significant impact for investors. One should instead make sure they are prepared to accept Black Swans in the short term and "time diversify" their investments over the long term, so that black swans become irrelevant. Investors should also beware that black swans are just as likely to be positive as they are negative returns and therefore over time the events offset each other.

"I think the machines just took over. There's not a lot of human interaction," said Charlie Smith, chief investment officer at Fort Pitt Capital Group. "We've known that automated trading can run away from you, and I think that's what we saw happen today." Likely, these words provide little comfort to the vast many investors or active fund managers who, with pre-set market sell orders or stop-loss orders, quickly had their money ripped out of the market as it sank like a rock; nor would they have been happy when they had no way to get their money back into the market when the market shot up like an Apollo

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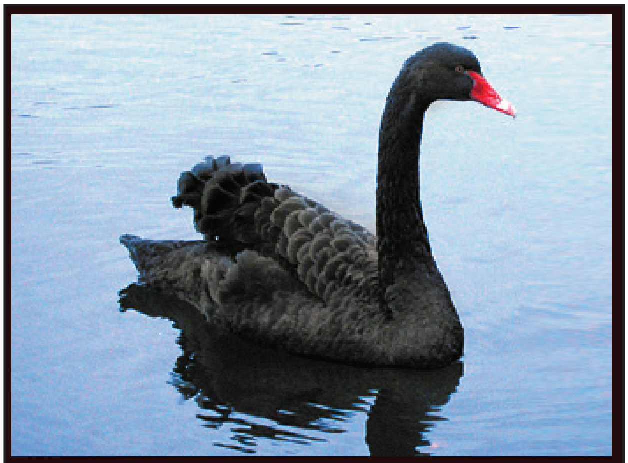
rocket. The money people lost in the mind-boggling freefall created by automated computers and antsy money managers is money they will NEVER get back, except for those trades that were cancelled by the exchange. It was something straight out of a science fiction movie where machines started taking over people's portfolios.

So you may be wondering how passively managed portfolios are impacted by such events? The rules of construction for the our favorite index funds from Dimensional Fund Advisors (DFA) allow for "patient trading" during the reconstitution or rebalancing of stocks in a fund. Most index funds adhere to a strict reconstitution date which coincides with the benchmark index. In contrast, DFA's are reconstituted on an ongoing and opportunistic basis. The objective of this strategy is to avoid the announcement of when certain stocks are added or dropped from the fund, creating what we like to call a "silent index."

These passive strategies can serve investors quite well in cases such as the whopping drop of last Thursday, as savvy passive fund managers provide liquidity to sellers of large blocks of shares. In many cases, this ability enables shrewd passive fund managers to complete their trades significantly below the price of the previous trade. IFA advises their clients to utilize passive fund managers who patiently trade with intelligence and confidence, as they benefit from the over-eagerness of those playing the speculation game.

Stated another way, while most traders are liquidity seekers (trying to dump stocks so they can buy the next hot stock), passive fund managers act as liquidity providers, relieving impatient active investors of those unwanted stocks -- frequently at a deep discount.



A Black Swan Sighting.. It is a Good or Bad Swan?

We encourage IFA clients to tie themselves to the mast, keep their eye on the long-term horizon and ignore the short term black swans. We know that we can not predict these rare events and recognize that such events are one of the reasons that our clients are rewarded for their patience over appropriate holding periods.

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Is your portfolio properly diversified to match your risk capacity? Find out with a visit to ifa.com. Take the Risk Capacity Survey. You will be matched with an Index Portfolio that's right for you. Or, if you would like to speak with one of IFA's Investment Advisor Representatives to learn how you can improve your diversification for risk-optimized returns, call 888-643-3133

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We match people with portfolios by carefully measuring risk capacity and matching the results to an appropriate risk exposure, in the form of an index portfolio. This process positions our clients for an investment experience that optimizes the trade off between risk and return, based on 80 years of historical index data.

IFA manages brokerage, IRA, 401k, 403b, profit sharing, and all other investment accounts. We also facilitate IRA rollovers from 401ks and 403bs. IFA also provides investment advice to individuals, trusts, corporations, non-profits, and public and private institutions. For institutional accounts, please see our Institutional Division website: ifa-i.com.

IFA assists clients in creating and purchasing diversified portfolios of index funds, primarily from Dimensional Fund Advisors (see DFA Brochure.), Vanguard, Fidelity and Barclays Global Investors (iShares). Dimensional Fund Advisors strives to deliver the performance of capital markets and add value through portfolio design and trading. The firm departs from the rules and rigidity of traditional index funds and avoids the cost-generating activity of stock picking and market timing. Instead DFA focuses on the dimensions of capital markets that reward investors and they deliver them as intelligently and effectively as possible. Their indexes tend to overweight small cap and value stocks, where expected returns are greater. Over 1,000 Investment Advisors rated DFA as the best overall company in the mutual fund business in several surveys. We primarily use their funds to create globally diversified portfolios of index funds. DFA funds are only available to individual investors through DFA approved investment advisors. IFA is approved for the purchase of DFA funds, but receives no compensation from DFA or any other investments. For institutional investors, we design diversified index manager portfolios to minimize vendor concentration risk.

You may select Charles Schwab & Company, Fidelity Investments or TD Ameritrade as the custodian for your account. (see SIPC) If you already have an account with any of these firms, you can easily assign your account to our Master Account to become one of our clients.

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