

Portfolio Advisory Services

Quarterly Newsletter

July 2021

Welcome

With the economy starting to recover from the COVID-19 pandemic and investor concerns turning increasingly toward inflation, Dimensional Founder David Booth talked with Nobel laureate Eugene Fama about inflation and how investors should think about it in their portfolios.

Inflation: An Exchange Between Eugene Fama and David Booth

Excerpts from this interview has been edited for clarity.

ON PREDICTING INFLATION

David Booth: Gene, you are a founding Director of Dimensional and have been involved in our research and corporate governance for more than 40 years. People may not know that you've also done a lot of research on inflation and interest rates.

We always tell people, "We don't try to forecast. We try to be prepared for various outcomes." Inflation is one of those things you want to be prepared for. There's a pickup in inflation risk that wasn't there, say, 10 years ago. Does that cause you to worry?

Eugene Fama: Historically what's happened is, when there's a spike, the spike persists for a long time. Inflation tends to be highly persistent once you get it. Once it goes down, it tends to be highly persistent on the downside. You've got to be prepared for that. Predicting next month's inflation may not be very hard because this month's inflation can be a pretty good predictor of next month's inflation, or next quarter's inflation, or even the next six months' inflation. Persistence is a characteristic of inflation.

We haven't been in a period of high inflation, or even moderate inflation, for at least 10 years, so I'm not particularly concerned that inflation will be high soon.

ON HOW INVESTORS SHOULD THINK ABOUT INFLATION AND THEIR FINANCIAL GOALS

Booth: Conditions change, so is there anything about the current environment and the risk of inflation heating up that would cause you to change your portfolio?

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Fama: I don't think anybody predicts the market very well. Market timing is risky in the sense that you've always emphasized: You may be out of the stock market at precisely the time when it generates its biggest returns. The nature of the stock market is you get a lot of the return in very short periods of time. So, you basically don't want to be out for short periods of time, where you may actually be missing a good part of the return.

I think you take a long-term perspective. You decide how much risk you're willing to take, and then you choose a mix of bonds, stocks, Treasury Inflation-Protected Securities, and whatever else satisfies your long-term goals. And you forget about the short term. Maybe you rebalance occasionally because the weights can get out of whack, but you don't try to time the market in any way, shape, or form. It's a losing proposition.

Booth: As you get to the point in life where you actually need to use your portfolio, does that change the kinds of allocations you'd want?

Fama: The classic answer to that was, yes, you'd shift more toward short-term hedges, short-term bonds. Once you had enough accumulated wealth that you thought you could make it through retirement, you'd want to hedge away any uncertainty that might disturb that. That's a matter of taste and your willingness to take risk and your plans for the people you will leave behind, like your charities or your kids. All of that will influence how you make that decision. But the typical person who thinks they'll spend all their money before they die probably wants to move into less risky stuff as they approach retirement.

Booth: The notion of risk is pretty fuzzy. For example, if I decide that I want to hold Treasury bills or CDs when I retire, and you did that 40 years ago, when we started the firm, and you've got that 15% coupon, that's pretty exciting. With \$1 million at 15%, you're getting \$150,000 a year. Today you might get less than 1%.

Fama: Right, but I remember when inflation was running at about 15%, so not much better off!

Booth: Those are different kinds of risks.

Fama: When you approach retirement, you're basically concerned about what your real wealth will look like over the period of your retirement, and you have some incentives to hedge against that. You face the possibility, for example, that if you invest in stocks, you have a higher expected return, but you may lose 30% in a year and that might be devastating for your long-term consumption.

Booth: I think part of planning is not only your investment portfolio, but what to do if you experience unexpected events of any kind. We're kind of back to where we start our usual conversation: "Control what you can control." You can't control markets. What you can do is prepare yourself for what you'll do in case bad events happen. Inflation is just one of many risk factors long-term investors need to be prepared for.

Eugene Fama is a member of the Board of Directors of the general partner of, and provides consulting services to, Dimensional Fund Advisors LP.

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Periodic Performance

As of 6/2021; Default Currency: USD

	Expense Ratio	Quarter 2021	YTD	1 Year	3 Years	5 Years	10 Years	Since Inception	Inception Date
Dimensional U.S. Large Company I	0.08%	8.54	15.22	40.76	18.62	17.60	14.77	7.41	9/23/1999
Dimensional U.S. Large Cap Value I	0.36%	5.22	20.71	50.50	10.71	12.56	11.82	10.19	2/19/1993
Dimensional Tax-Managed U.S. Marketwide Value	0.19%	4.73	18.69	48.32	11.59	12.74	12.01	8.11	12/14/1998
Dimensional U.S. Core Equity 2 I	0.19%	6.54	17.74	49.50	16.00	16.37	13.36	9.65	9/15/2005
Dimensional T.A. U.S. Core Equity 2 I	0.08%	7.41	N/A	49.91	16.19	16.47	13.44	N/A	10/4/2007
Dimensional U.S. Small Cap I	0.35%	4.21	23.34	65.00	11.23	14.04	11.86	10.79	3/19/1992
Dimensional U.S. Small Cap Value I	0.39%	4.01	31.57	80.43	8.62	12.42	10.46	11.51	3/2/1993
Dimensional U.S. Targeted Value I	0.33%	4.21	30.36	80.04	10.09	13.10	11.00	11.43	2/23/2000
DFA US Micro Cap I	0.51%	4.54	26.87	70.38	10.28	14.39	12.14	11.95	12/23/1981
DFA U.S. Small-Cap ETF	0.34%	3.91	N/A	63.53	10.91	13.98	11.86	N/A	12/15/1998
DFA U.S. Targeted Value ETF	0.34%	3.31	N/A	72.56	8.75	12.23	11.07	N/A	12/11/1998
Dimensional Large Cap International I	0.22%	5.55	10.41	34.71	8.60	10.56	5.85	5.93	7/17/1991
Dimensional International Value I	0.39%	4.17	16.39	45.08	4.44	9.34	3.96	6.10	2/15/1994
Dimensional Tax-Managed International Value	0.50%	4.19	15.19	43.29	4.38	9.24	3.84	5.58	4/16/1999
Dimensional International Small Company I	0.52%	5.80	12.07	45.01	7.86	11.22	7.54	7.29	9/30/1996
Dimensional International Small Cap Value I	0.49%	4.49	12.99	43.90	3.86	8.75	6.37	7.24	12/29/1994
Dimensional International Core Equity I	0.25%	5.37	11.78	40.18	7.63	10.70	6.19	5.66	9/15/2005
Dimensional Emerging Markets Core Equity I	0.39%	6.29	11.93	47.22	11.00	11.89	4.18	8.19	4/5/2005
Dimensional Emerging Markets I	0.43%	5.02	9.93	43.55	10.72	11.88	4.10	7.23	4/25/1994
Dimensional Real Estate Securities I	0.18%	12.37	21.77	32.85	12.44	7.76	10.10	9.82	1/5/1993
Dimensional International Real Estate Sec I	0.27%	7.11	9.47	32.18	5.03	4.24	5.26	1.30	3/1/2007
Dimensional One-Year Fixed-Income I	0.17%	0.00	0.00	0.07	1.45	1.18	0.86	4.35	7/25/1983
Dimensional Five-Year Global Fixed-Income I	0.26%	0.18	0.18	0.58	2.41	1.53	2.15	4.92	11/6/1990
Dimensional Two-Year Global Fixed-Income I	0.17%	0.00	0.10	0.27	1.76	1.32	1.00	2.92	2/9/1996
Dimensional Short Term Municipal Bond I	0.22%	0.07	0.07	0.13	1.06	0.75	0.87	1.61	8/20/2002
Dimensional CA Short-Term Municipal Bond I	0.22%	0.00	0.06	0.10	0.95	0.71	0.90	1.53	4/2/2007
Dimensional Inflation-Protected Securities I	0.11%	3.18	1.44	6.52	6.76	4.17	3.47	4.45	9/18/2006
Dimensional Investment Grade I	0.22%	2.05	-1.69	-0.01	6.30	3.37	3.81	3.85	3/7/2011
Dimensional Short-Term Extended Quality I	0.22%	0.27	0.09	1.19	2.77	1.83	1.99	2.85	3/4/2009
Dimensional Short-Duration Real Return Instl	0.22%	1.77	2.78	5.92	3.54	2.75	0.86	1.82	11/5/2013
Dow Jones U.S. Total Stock Market TR USD	N/A	8.29	15.27	44.29	18.69	17.86	14.66	10.87	1/2/1987
Russell 2000 TR USD	N/A	4.29	17.54	62.03	13.52	16.47	12.34	11.86	12/31/1978
MSCI EAFE GR USD	N/A	5.38	9.17	32.92	8.77	10.79	6.38	7.12	3/31/1986
MSCI EM GR USD	N/A	5.12	7.58	41.36	11.67	13.43	4.65	10.02	6/30/1988

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Barclays U.S. Corporate High Yield: The U.S. Corporate High Yield Bond component of the Barclays U.S. Aggregate/Bond Indices.

Barclays U.S. Aggregate Bond: Covers the U.S. dollar denominated, investment-grade, fixed-rate, taxable bond market of SEC registered securities. The index includes bonds from the Treasury, Government-Related, Corporate, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS sectors.

Barclays U.S. Government Index: The U.S. Government component of the Barclays U.S. Aggregate/Bond Indices.

MSCI EAFE (Europe, Australasia, Far East): A free float-adjusted market-capitalization index that is designed to measure developed market equity performance, excluding the U.S. and Canada. The MSCI EAFE Index currently consists of 21 developed-market country indices.

MSCI Emerging Markets: A free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

Russell 1000 Growth Index: Measures the performance of those Russell 1000 Index companies (the 1,000 largest publicly traded U.S. companies, based on total market capitalization) with higher price-to-book ratios and higher forecasted growth values.

Russell 1000 Value Index: Measures the performance of the large-cap-value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values. It is constructed to provide a comprehensive and unbiased barometer for the large-cap-value segment and is completely reconstituted annually to ensure new and growing equities are included and that the represented companies continue to reflect value characteristics.

Russell 2000 Index: Market-capitalization-weighted total-return index that measures the performance of the smallest 2000 companies in the Russell 3000 Index, representing approximately 8% of the Russell 3000 total market capitalization.

Russell 3000: Stock index consisting of the 3000 largest publicly listed U.S. companies, representing about 98% of the total capitalization of the entire U.S. stock market.

S&P 500: A market-capitalization-weighted index of 500 widely held stocks that is often used as a proxy for the U.S. stock market. Standard and Poor's chooses the member companies for the 500 based on market size, liquidity and industry group representation.

S&P Goldman Sachs Commodity Index: The S&P GSCI® is a composite index of commodity sector returns representing an unleveraged, long-only investment in commodity futures that is broadly diversified across the spectrum of commodities.

U.S. 10-year note: A debt obligation issued by the U.S. Treasury that has a maturity of 10 years.

U.S. GDP (Gross Domestic Product) Growth Rate: An aggregated measure of changes in value of the goods and services produced by the U.S. economy. It is calculated in real terms or inflation-adjusted terms to net out the effect of changes on the price of produced goods and services.

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