Dimensional

DIMENSIONAL FUND ADVISORS

# The Science of Investing

UNITED STATES UK/EUROPE CANADA ASIA PACIFIC

There is a **new model of investing:** a model based not on speculation but on the science of capital markets. Decades of research guide the way.

The mission of Dimensional Fund Advisors is to deliver the performance of capital markets and increase returns through state-of-the-art portfolio design and trading.

Discover how to become a Dimensional investor and capture what markets have to offer.

# Capital markets build wealth.

Rather than trying to outguess the market, let it work for you.

## MARKETS WORK

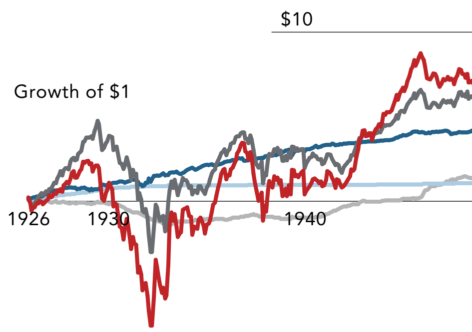
Markets throughout the world have a history of rewarding investors for the capital they supply. Companies compete with each other for investment capital, and millions of investors compete with each other to find the most attractive returns. This competition quickly drives prices to *fair value,* ensuring that no investor can expect greater returns without bearing greater risk.

Traditional managers strive to beat the market by taking advantage of pricing "mistakes" and attempting to predict the future. Too often, this proves costly and futile. Predictions go awry and managers miss the strong returns that markets provide by holding the wrong stocks at the wrong time. Meanwhile, capital economies thrive—not because markets fail but because they succeed.

## INVESTING VERSUS SPECULATING

The futility of speculation is good news for the *investor*. It means that prices for public securities are fair and that persistent differences in average portfolio returns are explained by differences in average risk. It is certainly possible to outperform markets, but not without accepting increased risk.

When you reject costly speculation and guesswork, investing becomes a matter of identifying the risks that bear compensation and choosing how much of these risks to take. Financial science identifies the sources of investment returns. Dimensional provides the tools and experience to achieve them.



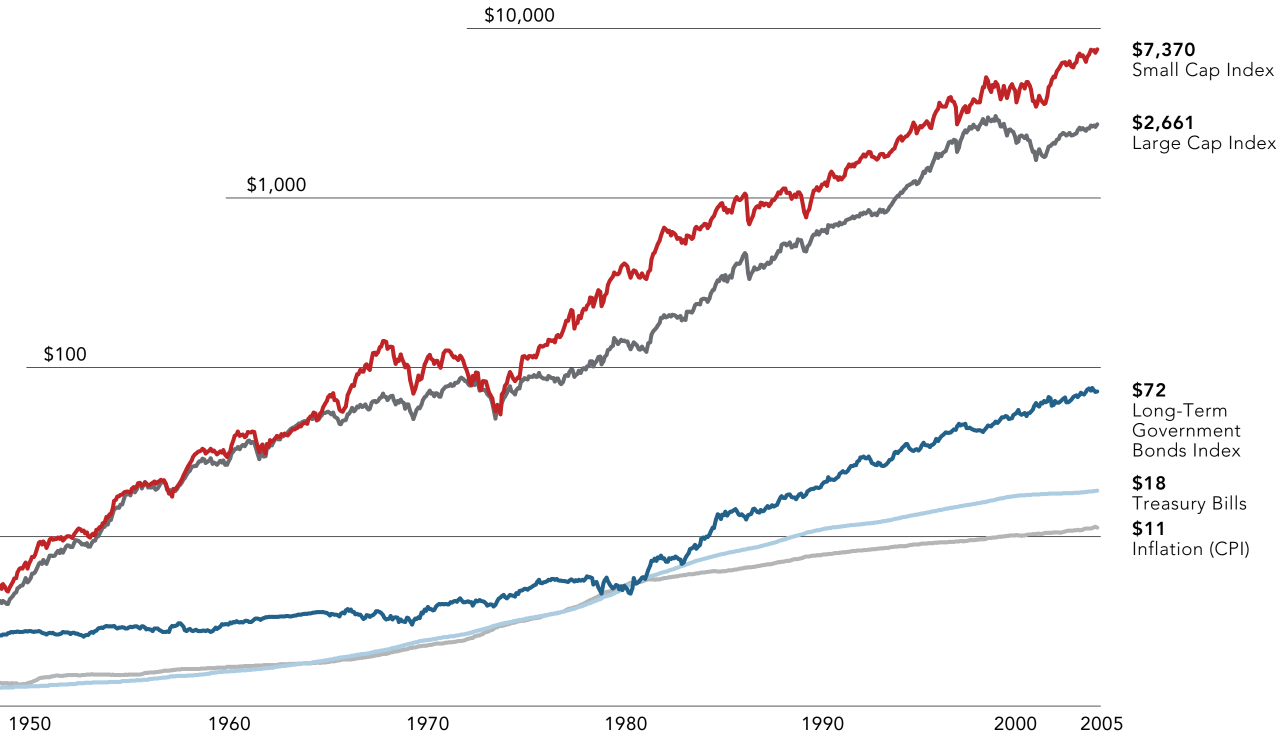

**A Picture of Growth**
Investors need look no further than historical performance to see how markets have compensated higher-risk investments with greater return.

## GAINING CLARITY

Working years ahead of the industry, Dimensional forged a new way to invest. The firm inaugurated its strategies in 1981 with early research into the stronger performance of small cap stocks. Later, a comprehensive analysis of stock prices worldwide deepened the strategy repertoire and set a new standard for portfolio design. This evolution reflects an abiding belief in financial science and the efficacy of capital markets.

At Dimensional, we see markets as an ally, not an adversary. Rather than trying to take advantage of the ways markets are mistaken, we take advantage of the ways markets are right—the ways they compensate investors. The firm designs portfolios to capture what the market offers in all its dimensions.

Relieve the stress and confusion of investing with a clear and empirical approach to wealth management.




For the eighty years from 1926 to 2005, the compound annual growth rate of return was 11.77% for the Small Cap Index, 10.36% for the Large Cap Index, 5.50% for the Long-Term Government Bonds Index, 3.70% for T-Bills and 3.05% for Inflation (CPI). Large Cap Index is the S&P 500 Index®; Long-Term Government Bonds Index is 20-Year US Government Bonds; T-Bills are One-Month US Treasury Bills; Inflation is the Consumer Price Index. Small Cap Index provided by the Center for Research in Security Prices (CRSP), University of Chicago. The S&P data are provided by Standard & Poor's Index Services Group. Bonds, T-Bills, and Inflation provided by © Stocks, Bonds, Bills and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work of Roger G. Ibbotson and Rex A. Sinquefield).

Indexes are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio.

## TAKE RISKS WORTH TAKING

Evidence from practicing investors and academics alike points to an undeniable conclusion: Returns come from risk. Gain is rarely accomplished without taking a chance, but not all risks carry a reliable reward. Financial science over the last fifty years has brought us to a powerful understanding of the risks that are worth taking and the risks that are not.

Everything we have learned about expected returns in the equity markets can be summarized in three dimensions. The first is that stocks are riskier than bonds and have greater expected returns. Relative performance among stocks is largely driven by the two other dimensions: small/large and value/growth. Many economists believe small cap and value stocks outperform because the market rationally discounts their prices to reflect underlying risk. The lower prices give investors greater upside as compensation for bearing this risk.

Dimensional approaches fixed income primarily as a strategy to maximize overall portfolio benefit. Shorter-term, high-quality debt instruments tend to have less risk. Dimensional engineers lower-risk bond strategies so investors can temper their total portfolio volatility or take more risk in equities, where expected returns are greater.

Structuring a strategy around compensated risk factors lends purpose to an investor's portfolio. Rather than analyzing individual securities, investing becomes a relatively simple matter of deciding how much stock to hold versus bonds, and how small, large, value-, or growth-tilted the stocks should be. By focusing on what matters, Dimensional focuses your efforts.

A better way to

**invest.**

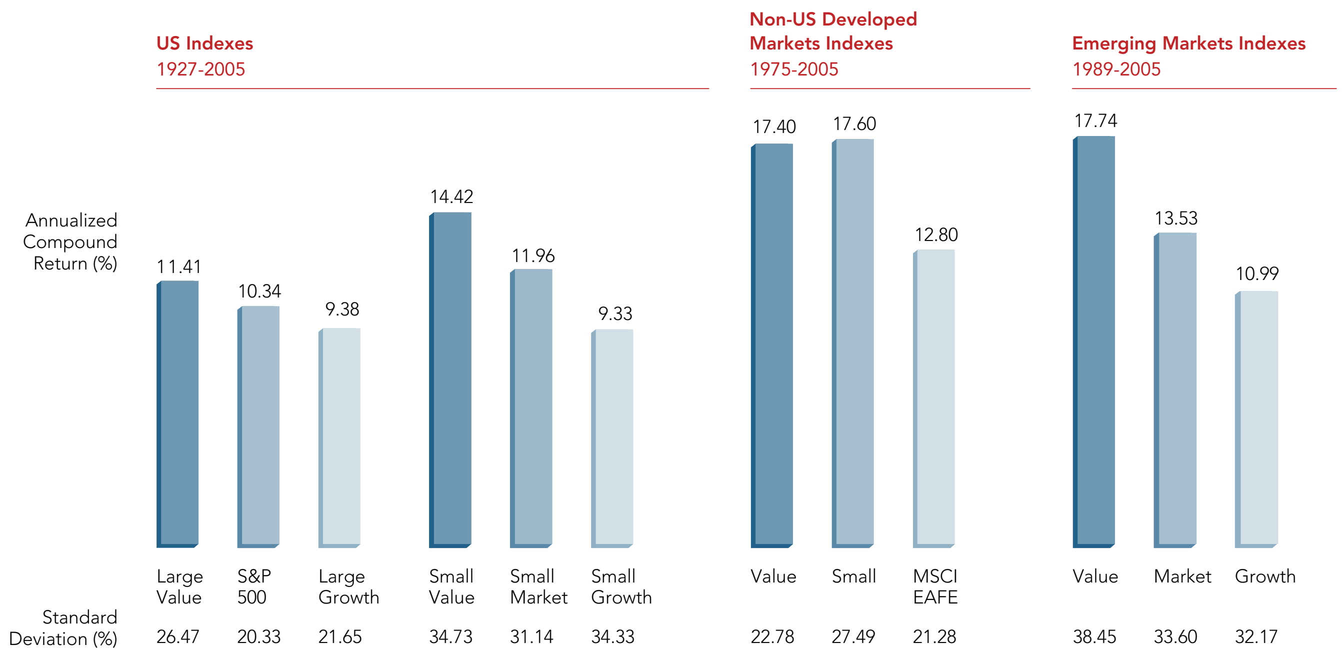
Dimensional identifies what matters, and gives you the tools to succeed.

## STRUCTURE IS THE STRATEGY

Successful investing means not only capturing risks that generate expected return but reducing risks that do not. Avoidable risks include holding too few securities, betting on countries or industries, following market predictions, and speculating on "information" from rating services. To all these, diversification is the antidote. It washes away the random fortunes of individual stocks and positions your portfolio to capture the returns of broad economic forces.

Traditional managers do one of two things: Active managers focus on picking individual stocks, the antithesis of diversification; index managers hold many securities but mimic arbitrary benchmarks.

Dimensional chooses a different path. It structures strategies based on scientific evidence rather than on commercial indexes. The firm diversifies not only in the amount of securities it holds (thousands) but in the range of capital market strategies it explores and develops. Small cap strategies target smaller stocks more consistently. Value strategies target value returns with greater focus. As a result, investors achieve more consistent portfolio structure.




**Size and Value Matter**

Small cap and value effects are strong around the world. Smaller and lower-priced value stocks have higher risk and greater expected returns than larger and higher-priced growth stocks.

In US dollars. Developed markets value and growth index data provided by Fama/French. The S&P data are provided by Standard & Poor's Index Services Group. US Small Cap Index provided by the Center for Research in Security Prices (CRSP), University of Chicago. International Small Cap index data: 1970–June 1981, 50% UK small cap stocks provided by the London Business School and 50% Japan small cap stocks provided by Nomura Securities; July 1981–present: simulated by Dimensional from StyleResearch securities data; includes securities of MSCI EAFE Index countries, market-capitalization weighted, each country capped at 50%. MSCI data copyright MSCI 2005, all rights reserved. Emerging markets index data simulated by Fama/French from countries in the IFC Investable Universe. Simulations are free-float weighted both within each country and across all countries.

Indexes are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio. Compound returns have an assumed rate of return, are hypothetical, and are not representative of any specific type of investment. Standard deviation is one method of measuring risk and performance and is presented as an approximation.

## SMART TRADING INCREASES RETURNS

Trading stocks—especially small cap stocks—is expensive. Most managers are only too willing to pay these costs to meet a forecast or follow an index. The costs they generate are buried in financial statements and corporate ledgers, but the investor always pays in the form of lowered returns. Careful trading can reduce or even reverse the costs borne by traditional managers. The savings accrue directly to the investor's return.

Dimensional focuses on trading. Our refusal to forecast or follow indexes gives us negotiating strength. Where others feel compelled to trade, the firm can take its time. Dimensional transacts in more than 12,000 equity securities per year. It is more important that we capture the systematic performance of broad market dimensions than the random fluctuations of any single security. It is more important that we keep costs low—patiently and expertly.

For more than twenty-five years, Dimensional has developed its trading infrastructure to make this possible. Five state-of-the-art desks around the world ensure a formidable presence in financial markets. Such a large scale brings opportunity for cost-effective and lucrative trades. A vast universe of illiquid stocks is transacted in a coordinated way. The result: performance driven by a potent combination of investment philosophy and trading power.

A Dimensional investor is not satisfied with traditional definitions of returns. By being patient when others are pushing to transact and by being thrifty when others pay a premium, the firm works daily to improve your results.

# Better investing through science.

At Dimensional, a system of research and practice generates financial progress.

## PIONEERS IN FINANCIAL ENGINEERING

Dimensional is always researching tomorrow's solutions today. We do this through deep working relationships with leading financial economists. By acting as a conduit between scientists and practicing investors, Dimensional has pioneered many strategies and consulting technologies now taken for granted in the industry.

The firm started with a single micro cap portfolio that helped pioneer small cap investing. Since then, the fund family has grown to include more than seventy portfolios. This would seem to be a perplexing number of choices were it not for the consulting technology and investment philosophy that evolved alongside the strategy line. Dimensional's funds are coordinated by elegant models of risk and return, trial-tested in academic labs and time-tested in actual portfolios.

The result is increased flexibility. A client's portfolio can target its goals with a wide range of highly engineered vehicles—a range that continues to grow for tomorrow's needs.


**Idea Growth Engine**
Clients benefit when research and experience combine to solve new investment challenges. As often as a research innovation generates a new technology, a client need or investment problem drives a new solution.

## THE NEXT FRONTIER

The latest and perhaps most complete manifestation of Dimensional's investing paradigm is its core equity strategies. Each core strategy targets the entire stock market as its eligible universe. But unlike conventional approaches, the securities are not held in their market-value proportions. The portfolios increase the relative weight of small cap and value stocks where expected returns are greater. Because the architecture is seamlessly integrated and includes the full range of securities, the costs normally associated with maintaining multiple vehicles are greatly reduced.

Frictions caused by risks and costs are continually managed in a fully diversified strategy designed to increase client wealth. Dimensional's advanced core technology can form the ideal foundation for any modern investment plan.

**Small Cap Factor**

1981

Dimensional pioneers the industry's first passively managed small cap fund.

**Strategies since 1981:**
US Micro Cap
US Small Cap
International Small Cap
Emerging Markets Small Cap

**Fixed Income**

1983

Dimensional focuses on quality to deliver fixed income that reduces risk.

**Strategies since 1983:**
One-Year
Two-Year Global
Five-Year Government
Five-Year Global
Intermediate Government
Short-Term Municipal

**Value Factor**

1992

Dimensional's multifactor approach expands flexibility across stock market dimensions.

**Strategies since 1992:**
US Small Cap Value
US Large Cap Value
International Small Cap Value
International Value
Emerging Markets Value

**Tax Management**

1999

Dimensional engineers portfolios tailored to client goals and tax costs.

**Strategies since 1999:**
US Small Cap
US Small Cap Value
US Equity
US Marketwide Value
International Value

**Applied Core Equity**

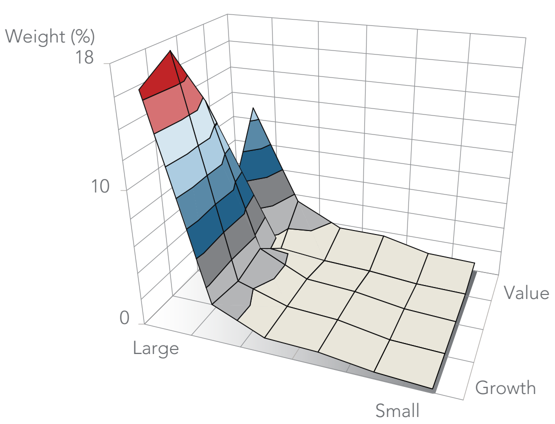
The result of decades of experience, integrated portfolios deliver broad diversification and low-friction factor exposures—the synthesis of Dimensional's investment philosophy.

**Strategies since 2004:**
US Core Equity
Canadian Core Equity
Australian Core Equity
International Core Equity
Emerging Markets Core Equity

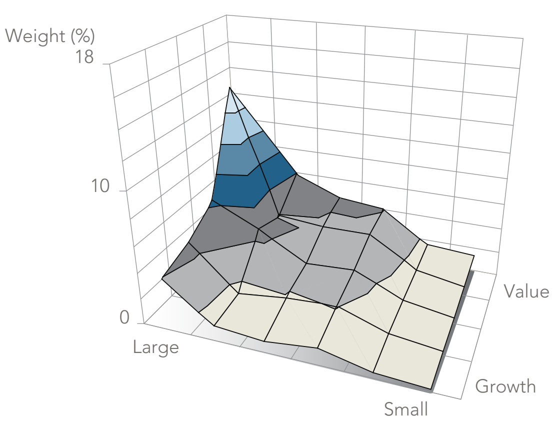
**Integration across the Market**

Surface maps of the equity weights in the total stock market and Dimensional's Core Equity strategy give a sense of the breadth and complexity of the core structure. Each applied core strategy covers most stocks in the market with increased weighting in small cap and value regions.

**Total Stock Market**




**Core Equity Strategy**




## A PLAN FOR THE FUTURE

The work is never complete. The final chapter will never be written. But a process grounded in science can only improve your financial plan. The peace of mind and clarity of such an approach would be reward enough were it not for its long history of documented performance.

By applying modern financial principles to wealth management, Dimensional remains ahead of the industry, ready to address your future needs.

Get involved today. Become a Dimensional investor and bring science to the life of your wealth.

An approach that targets the expected returns of capital market dimensions completes your investment program.

For more on how you can become a Dimensional investor, visit us online.

www.dimensional.com

### Principal Risks of Investing

The principal risks associated with an investment are fully described in the prospectus in the section called "Principal Risks." The value of an investment will fluctuate based on economic, political, and stock-specific events, and there is a chance you will lose money. Small company stocks may fluctuate more in price than those of large companies. Stocks of non-US companies may also fluctuate due to these factors and expose investors to fluctuations in currency exchange rates. The stocks of companies in emerging markets are subject to additional risks due to the unstable nature of some governments and the small and illiquid nature of their securities markets. The use of derivatives to hedge specific risks may increase expenses, and there is no guarantee that a hedging strategy will work.

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