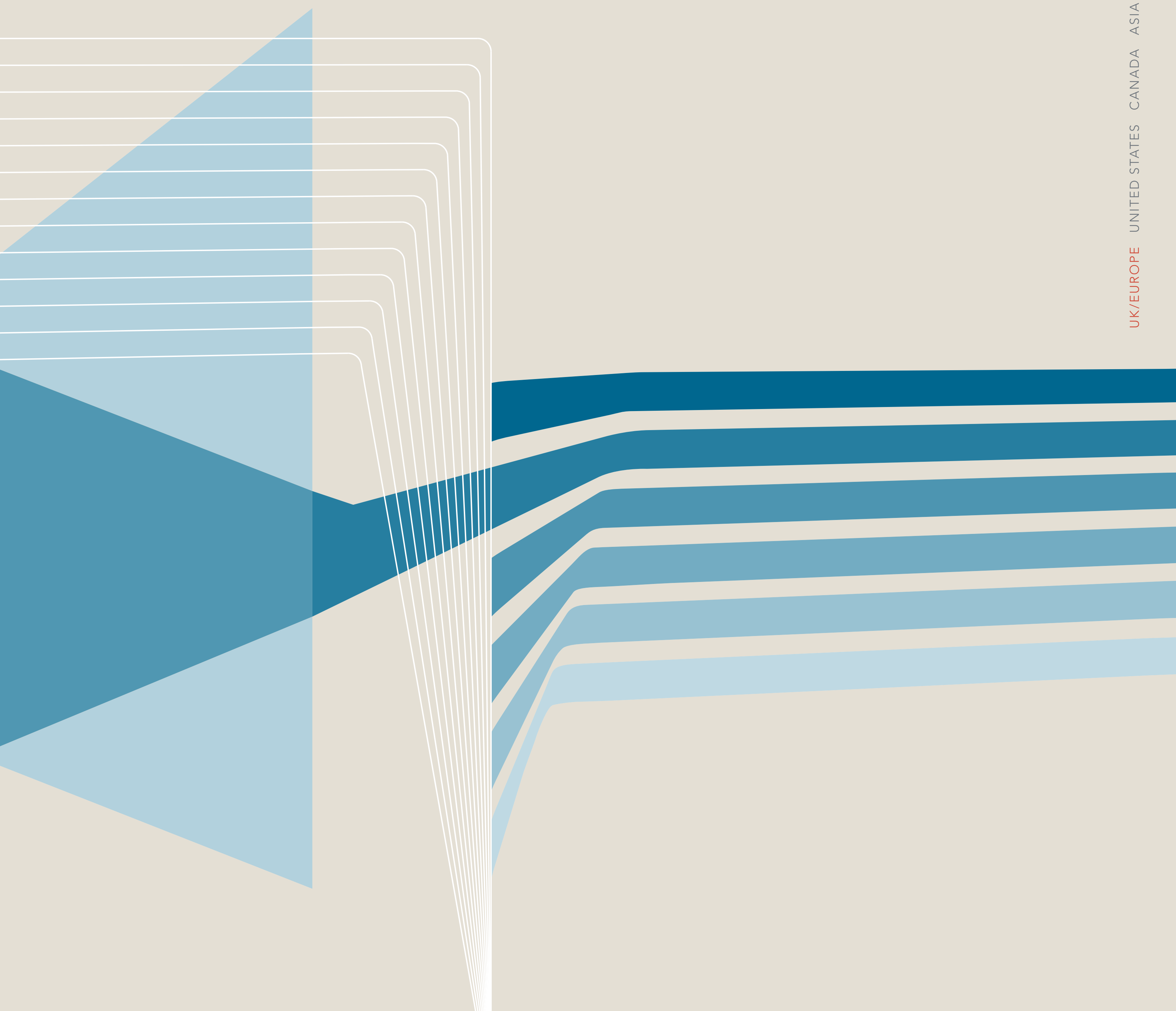
Dimensional

DIMENSIONAL FUND ADVISORS

# The Science of Investing

UK/EUROPE UNITED STATES CANADA ASIA PACIFIC



There is a **new model of investing:**
a model based not on speculation but on the scientific study 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 long-term investors for the capital they supply. Companies compete with one another for investment capital, and millions of investors compete with one another to find the most attractive returns. This competition tends to drive prices to *fair value,* making it difficult for investors to achieve greater returns without bearing greater risk.

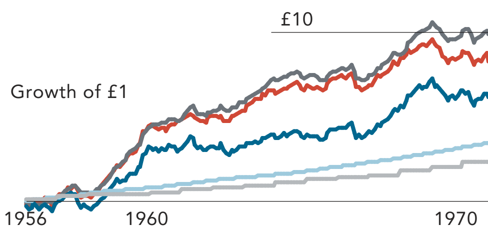
Traditional investment managers strive to beat the market by taking advantage of pricing “mistakes” and attempting to predict the future. Too often, this proves costly and futile. Predictions go awry and managers miss the strong returns that markets provide by holding the wrong stocks at the wrong time. 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 generally fair and that persistent differences in average portfolio returns are largely explained by differences in average risk. It is certainly possible to outperform markets, but not in general without accepting increased risk.

When you reject costly speculation and guesswork, investing becomes a matter of identifying the risks that are likely to be rewarded in the long term and choosing how much of these risks to take. Financial economists have identified the risk factors that seem to drive investment returns. Dimensional provides the tools and experience to capture 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.




RISKS OF INVESTING

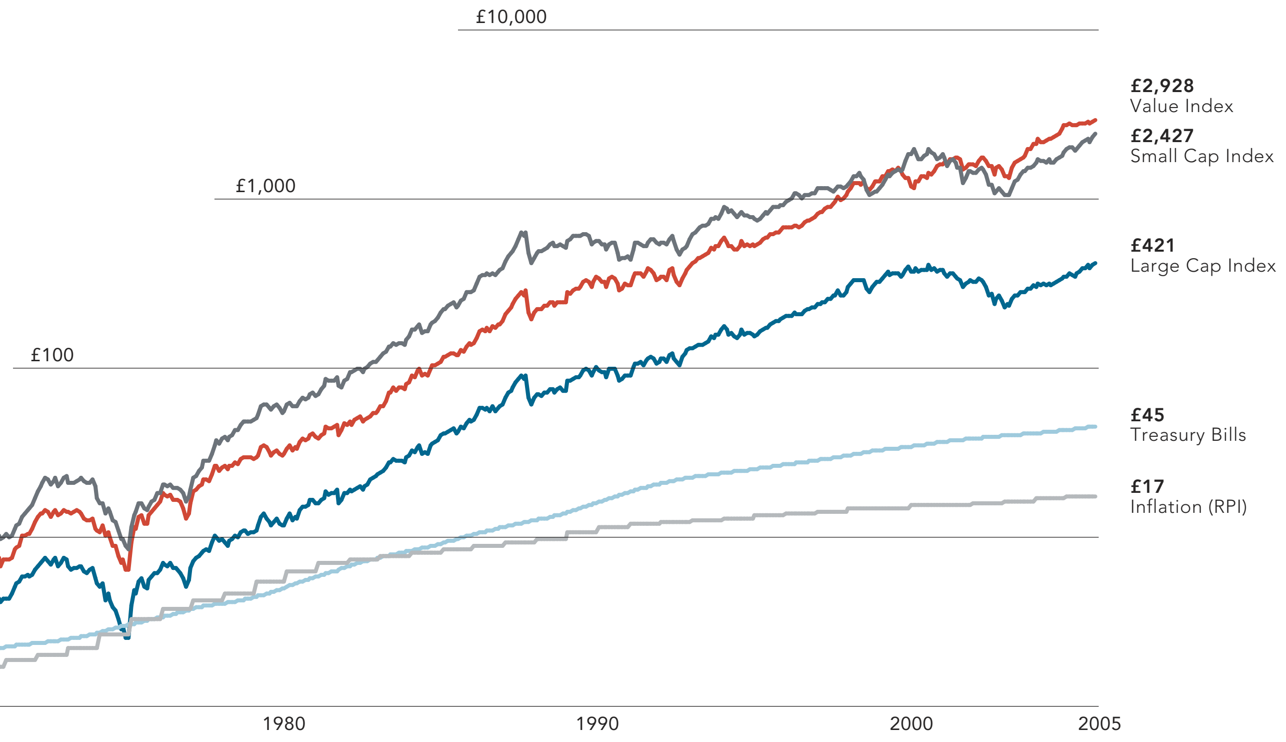
The value of investments and any income from them may go down as well as up. You may not get back all of your original investment. You should not make any assumptions about potential income or returns based on anything included within this article. Past performance should not be considered a guide to future performance. Unless exclusively investing in the UK, foreign exchange exposure exists in all funds. Changes in foreign exchange rates may cause the value of investments to go down or up. It may also cause income from investments to go down or up. The principal risks associated with an investment are fully described in the prospectus.

## GAINING CLARITY

Dimensional has pioneered a new way to invest. The firm inaugurated its strategies in 1981 with early research into the 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 long-term 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 fifty years from 1956 to 2005, the compound annual growth rate of return was 17.31% for the Value Index, 16.87% for the Small Cap Index, 12.85% for the Large Cap Index, 7.91% for T-Bills, and 5.86% for Inflation (RPI). Value Index data provided by the London Business School and simulated by Dimensional from StyleResearch data. Small Cap Index: 1956-June 1981 provided by London Business School and ABN AMRO; July 1981-present simulated by Dimensional from StyleResearch securities data. Large Cap Index is the FTSE All-Share Index published with the permission of FTSE. T-Bills: 1955-1974, UK Three-Month T-Bills provided by the London Share Price Database; 1975-present, UK One-Month T-Bills provided by the Financial Times. Inflation is the UK Retail Price Index provided by the Office for National Statistics.

Indices 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 practising investors and academics alike points to an undeniable conclusion: Returns are related to risk. Gain is rarely accomplished without taking a chance, but not all risk-taking is rewarded. Financial economics over the last fifty years has brought us to a powerful understanding of the risks that are generally rewarded and the risks that are not.

Everything we have learned about expected returns in the equity markets can be summarised in three dimensions. The first is that stocks are riskier than bonds and have greater expected long-term 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 have outperformed over the long term because the market rationally discounts their prices to reflect underlying risk. The lower prices give investors greater upside potential as compensation for bearing this risk.

A better way to

# invest.

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

Dimensional approaches fixed interest primarily as a strategy to maximise 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.

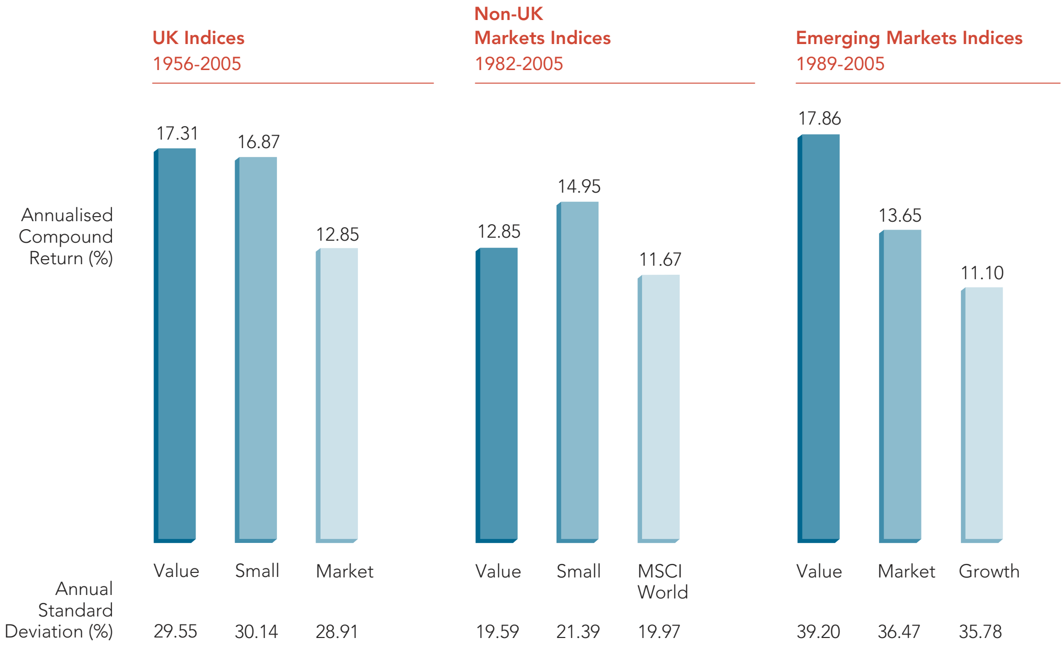
Structuring a strategy around compensated risk factors lends purpose to an investor's portfolio. Rather than analysing individual securities, investing becomes a relatively simple matter of deciding how much stock to hold versus bonds, and how small, large, value-, or growth-tilted the stocks should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

## 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 indices. The firm diversifies not only in the number of securities it holds (thousands) but in the range of capital market strategies it explores and develops. Our small cap strategies target smaller stocks more consistently than many managers. Our 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 British pounds. UK Value data provided by the London Business School and simulated by Dimensional from StyleResearch data. UK Small: 1956-June 1981 provided by London Business School and ABN AMRO; July 1981-present simulated by Dimensional from StyleResearch securities data. UK Market is the FTSE All-Share Index, published with the permission of FTSE. Non-UK Value is the MSCI World ex UK Index, net dividends. Non-UK Small: 50% EMEA small companies simulated by Dimensional from StyleResearch securities data (25% continental Europe, 12.5% Asia Pacific ex Japan, and 12.5% Japan) and 50% Fama/French US Small Cap Index. MSCI indices are net dividends; data copyright MSCI 2006, 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.

Indices 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 indices gives us negotiating strength. Where others feel compelled to buy and sell, the firm can take its time. Dimensional trades more than 12,000 equity securities per year. It is more important to us 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 trading desks on three continents 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 co-ordinated 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.

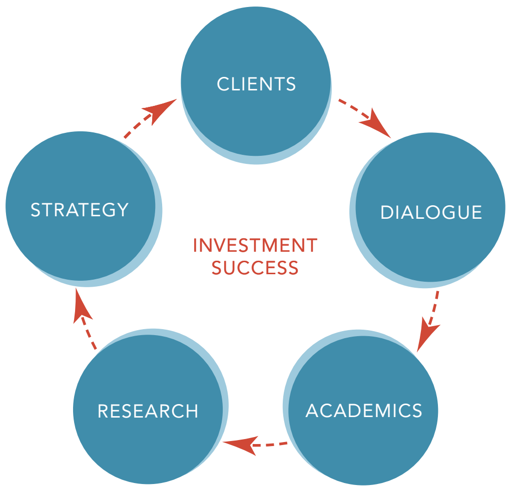
At Dimensional, a system of research and practice generates financial progress.

## 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 practising investors, Dimensional has pioneered both strategies and consulting approaches now taken for granted in the industry.

The firm started with a single micro cap portfolio that helped pioneer passive 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 co-ordinated by elegant models of risk and return, trial-tested by academics 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 a broad 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 portfolio designed to increase client wealth. Dimensional's applied core equity strategies can form an ideal foundation for any modern investment plan.

**Small Cap Factor**

1981

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

**Fixed Interest**

1983

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

**Value Factor**

1992

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

**Tax Management**

1999

Dimensional engineers portfolios tailored to client goals and tax costs.

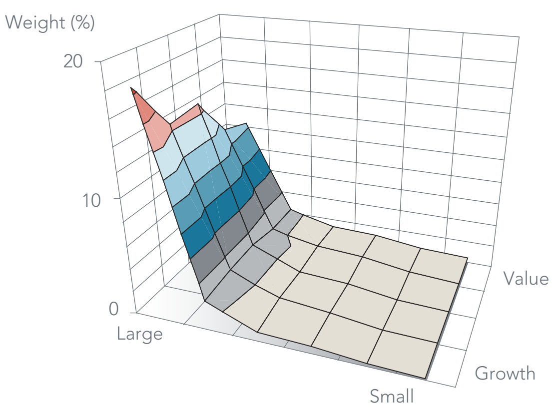
**Applied Core Equity**

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

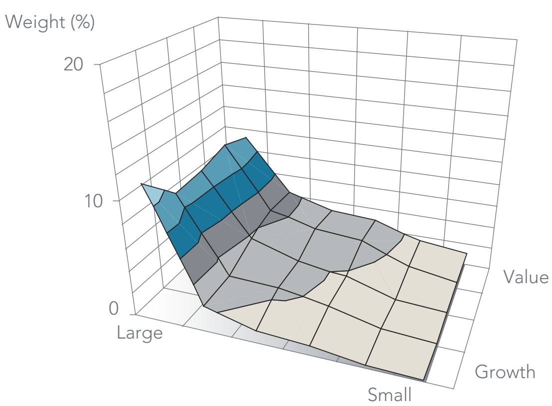
### Integration across the Market

Surface maps of the equity weights in the total stock market and Dimensional's US 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 US Stock Market**




**US Core Equity Strategy**




Total US stock market and US Core Equity strategy simulations provided by Fama/French. Simulations are not available for UK investment.

## 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 programme.

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

www.dfauk.com

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