MARYLAND CAPITAL ADVISORS INC.
◇ Registered Investment Advisory ◇

**INVESTMENT COMMENT** **April 25, 2007**

# Update on our Passive, Asset Class Balanced Strategy

"DGSIX Closes at Record High $13.35, +5.55% in 2007!" will NOT be the headline in tomorrow's newspapers. It is, however, a far more interesting story than the bold-fonted, adjective-laden "DJIA SURGES ABOVE 13,000" stories that will be all over the print media.

What is DGSIX? How could this be more interesting than DJIA over 13,000? DGSIX is the ticker symbol for a passively-managed fund that targets a 60% stock / 40% bond portfolio allocation. DGSIX's underlying investments comprise over "10,000 securities across more than thirty-five countries."[1] Could a diversified portfolio with only 60% targeted exposure to equities compete with popular 100% equity indexes? Yes. The table below illustrates why my suggested headline above would be more relevant for investors seeking to maximize return and minimize risk. Note the comparable YTD returns: DGSIX +5.6%, DJIA +5.6%. The global 60% / 40% balanced portfolio has the same return, with less risk.

| **Table 1: Passive Portfolios vs. Indexes** | Price 4/25/07 | Return YTD | Return 2006 | 1-Year Risk |
|---|---|---|---|---|
| **Passively-Managed 60/40 Funds** | | | | |
| Vanguard 60/40 Allocation (ticker: VBINX) | $22.20 | +4.6% | +11.0% | 4.1 |
| DFA 60/40 Allocation (ticker: DGSIX) | $13.35 | **+5.6%** | +13.9% | **4.4** |
| **Popular Market Indices** | | | | |
| Dow Jones Industrial Average | 13,089.89 | **+5.6%** | +18.9% | **6.2** |
| S&P 500 Index | 1,495.42 | +5.9% | +15.9% | 6.2 |
| NASDAQ Composite Index | 2,547.89 | +7.4% | +7.1% | 13.2 |

*Source: Bloomberg L.P.*
*Note: Returns are calculated inclusive of reinvested dividends.*
*Risk is standard deviation of returns.*
*Index risk and return are calculated using tradeable, index-equivalent ETFs.*

The point is not that it really matters how well a balanced portfolio has performed over the last 3+ months. What is important for investors to appreciate is that the DJIA is not a diversified equity portfolio – it is merely a benchmark for large company stocks. The fund managers of DGSIX, Dimensional Fund Advisors (DFA), rely on long-standing academic research that has identified long-term factors associated with risk and return: company size and stock-price valuation. Large company stocks are but one asset class "ingredient" in a truly diversified portfolio. So, since it would not be prudent to construct an entire stock portfolio with large company stocks, we really need to ask more probing questions than "Where's the Dow?" I suggest something like "How are various asset classes performing?"

Perhaps Table 2 can help. This table shows the YTD returns of the "top-10" asset classes – a subset of the building blocks used when we construct a portfolio. The data shows that the DJIA and S&P 500 ETFs do not even make the "top-10" list – so, again, why all the hype



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about the DJIA? Mid-sized companies, International Real Estate, International stocks, Emerging Market equities, and Commodities are the YTD asset class leaders.

| **Table 2: Top-10 Asset Classes**<br>Dec 29, 2006 – April 25, 2007 | Total Return |
|---|---|
| Mid Cap Value | 9.9% |
| Mid Cap Growth | 9.8% |
| Real Estate – International | 9.8% |
| Mid Cap Core | 9.7% |
| Large Cap International | 9.3% |
| Emerging Markets | 8.7% |
| Commodities | 7.4% |
| Small Cap Growth | 7.2% |
| Large Cap Growth | 6.9% |
| Large Cap Core | 6.3% |
| **S&P 500 ETF** | **5.9%** |
| **DJIA ETF** | **5.6%** |

*Source: Bloomberg L.P.*
*Note: Returns include reinvested dividends.*

Clearly, DJIA 13,000 is irrelevant for our passive asset allocation strategy. However, the fact that so many asset classes have performed well this year means that diversified equity portfolios have had a great start to 2007 – even better than we could have expected.

Market movements can not be predicted with any consistency, nor can "winning" asset classes be chosen in advance. Client portfolios are better-served by diligent monitoring of each asset class target and, when prudent and cost-effective, our periodic portfolio rebalancing. This enforces the discipline of "selling high" and "buying low", while enjoying the tax-efficiency of passively-managed (not actively-traded) portfolios.

Michael Damas

[1] Source: Dimensional Fund Advisors, March 31, 2007.

| | **Table 3: Asset Class Performance**<br>December 29, 2006 – April 25, 2007 | Total Return |
|---|---|---|
| **EQUITIES** | Large Cap Growth | 6.9% |
| | Large Cap Core | 6.3% |
| | Large Cap Value | 5.9% |
| | Mid Cap Growth | 9.8% |
| | Mid Cap Core | 9.7% |
| | Mid Cap Value | 9.9% |
| | Small Cap Growth | 7.2% |
| | Small Cap Core | 6.0% |
| | Small Cap Value | 4.8% |
| | Large Cap International | 9.3% |
| | Emerging Markets | 8.7% |
| **ALTS** | Real Estate – International | 9.8% |
| | Real Estate – US REITs | 5.7% |
| | Commodities | 7.4% |
| | Hedge Fund of Funds | N/A |
| **BONDS** | Treasuries 1-3yr | 1.6% |
| | Treasuries 7-10yr | 2.0% |
| | Treasuries 20-30yr | 1.2% |
| | Treasury IPS (TIPs) | 3.0% |
| | Mortgage-Backed (MBS) | 1.4% |
| | Inv Grade Short Duration | 1.6% |
| | Inv Grade Intermediate | 1.8% |
| | Inv Grade Long Duration | 1.0% |
| | High Yield Intermediate | 2.9% |
| | Municipals Short Duration | 0.8% |
| | Municipals Intermediate | 0.6% |
| | Municipals Long Duration | 0.5% |
| | International | 2.4% |
| | Emerging Markets | 3.5% |
| | Floating-Rate | 1.7% |
| **INDEX** | S&P 500 ETF | 5.9% |
| | DJIA ETF | 5.6% |
| | NASDAQ Composite ETF | 7.4% |
| | US Domestic Bonds ETF | 1.8% |
| | US Dollar Index | -2.7% |

*Source: Bloomberg L.P.*
*Note: Returns include reinvested dividends.*