

Stock Price Best Value Guide, War or Not

By Ben Wilmot
Australian Financial Review
March 2003



A visit from one of the world's leading investors casts a fresh light on how markets work and the effects of the war in Iraq.

"I am looking at the markets right now in the same way I always look at the markets," said Kenneth French, director of investment strategy at Dimensional Fund Advisors.

Mr. French is best known for developing, with the investment guru Eugene Fama, the three-factor model to measure different types of risk. He is also a professor at the Tuck School of Business in Hanover, New Hampshire.

He observes that war can certainly change prices quickly, but is circumspect about the limits of this knowledge. "War makes it harder to value the future because of increased uncertainty," Mr. French said.

But according to his approach, which he calls equilibrium, markets are efficient and able to assemble and evaluate information effectively so the price of a stock usually is the best estimate of its intrinsic value—war or no war.

"[So] I don't believe that war means that prices are too high or too low on average. The market is smarter than we are," Mr. French said, reciting a core belief of DFA.

DFA aims to gain an exposure to factors such as the cost of capital that drive returns, and to take advantage of favourable trading costs. But the firm doesn't try to out-guess the market: "You're always better assuming the prices are right," DFA's co-chairman, Rex Sinquefield, said.

The investment style this belief produces is able to capture style tilts (times at which one form or another of investment becomes more successful) such as between growth and value, but is not active in trying to identify undervalued or overvalued stocks.

Instead, DFA seeks to add value in two areas. The first is finding unique trading opportunities and exploiting them. Unlike active investors, DFA believes it can exploit liquidity opportunities because it does not need to hold particular stocks in its portfolio.

"We are in a position to provide liquidity and get paid for it," Mr. French said. "We don't hate any stocks, we're not in love with any stocks."

The second is that DFA promises disciplined strategies which are designed to capture the particular style that an investor favours. Mr. Sinquefield contrasts DFA's way of organising portfolios around particular risk-based factors, or risk-based asset classes, with those of other fund managers who are not necessarily organised around clearly identified risks.

"I think of this as our fundamental advantage . . . we have this disciplined equilibrium view of the markets which we work hard to maintain," Mr. French said.

DFA has been trading in Australia since the late 1980s and believes that taking advantage of liquidity opportunities locally does not differ significantly from other markets.¹

"The benefits that we advertise are not because others aren't doing it exactly our way, it's just that we are taking on certain types of risk [by buying blocks of stock at a discount and providing liquidity] that the markets compensate on average," Mr. Sinquefeld said.

¹ Investment advisor services in Australia are provided by DFA Australia Inc., a majority-owned subsidiary of Dimensional Fund Advisors Inc.

This article contains the opinions of the author(s) and those interviewed by the author(s) but not necessarily Dimensional Fund Advisors Inc. or DFA Securities Inc., and does not represent a recommendation of any particular security, strategy or investment product. The opinions of the author(s) are subject to change without notice. Information contained herein has been obtained from sources believed to be reliable, but is not guaranteed. This article is distributed for educational purposes and should not be considered investment advice or an offer of any security for sale. Past performance is not indicative of future results and no representation is made that the stated results will be replicated.

Dimensional Fund Advisors Inc. is an investment advisor registered with the Securities and Exchange Commission. Consider the investment objectives, risks, and charges and expenses of the Dimensional funds carefully before investing. For this and other information about the Dimensional funds, please read the [prospectus](#) carefully before investing. Prospectuses are available by calling Dimensional Fund Advisors Inc. collect at (310) 395-8005; on the Internet at www.dimensionalfundadvisors.com; or, by mail, DFA Securities Inc., c/o Dimensional Fund Advisors Inc., 1299 Ocean Avenue, 11th Floor, Santa Monica, CA 90401.

Mutual funds distributed by DFA Securities Inc.