

Dimensional Advantages

Patient Trading – The goal of an index-based strategy is zero tracking not return enhancement. Index-based strategies often pay liquidity premiums to minimize tracking error, especially around reconstitution dates. The reconstitution cost can be well over 1% per year for small cap index-based strategies. Dimensional avoids reconstitution costs by not tracking indexes and pays very close attention to liquidity constraints when they trade. Dimensional's goal is to be a liquidity provider to the market rather than a liquidity seeker, which allows it to maintain very low transaction costs. Through patient trading DFA mitigates market impact to its funds.

Asset Class Design – Dimensional's asset class funds typically have deeper exposure to small and/or value stocks compared to most index-based strategies resulting in higher expected returns. In addition, Dimensional filters out stocks that don't meet the definition of the asset class such as REITs or have been shown to have lower expected returns such as recent IPOs, highly regulated utilities (utilities have high book to market ratios like value stocks, but they have low betas), and extreme small growth stocks. The end result is a more pure strategy with a higher expected return than the respective index.

Dynamic Rebalancing – Index-based funds only rebalance when indexes are reconstituted and reconstitution is typically infrequent. For example, Russell indexes reconstitute only once a year at the end of June regardless of what happens to the stocks in the index throughout the year. This results in the potential for style drift which may lower expected returns. Dimensional's funds, on the other hand, are dynamically rebalanced via daily cash flows resulting in relatively constant exposure to the specific asset class through time.

Securities Lending – Since Dimensional is not concerned with stock picking and market timing it concentrates on other ways to add value to its strategies such as securities lending. DFA is one of the industry leaders in securities lending adding a substantial amount of revenue to the funds. Unlike many other investment companies all the revenue generated from securities lending goes to shareholders in the funds.

Momentum Screens – Many recent academic studies have documented statistically significant momentum effects. Stocks that have been falling for several months tend to continue to fall on average and stocks that have been increasing for several months tend to continue to increase on average. To immunize the funds from negative momentum Dimensional uses filters to delay purchasing such stocks. Dimensional is able to capture positive momentum because its funds have hold ranges to minimize turnover. Thus, stocks that grow out of the asset class boundary are held until they grow out of the hold range.

Core Technology – Dimensional's core funds allow investors to achieve marketwide exposure with a higher expected return by tilting toward small and value stocks. The technology behind the fund construction allows stocks to migrate through the fund as they change category through time, thus minimizing turnover and taxes.

Diversification (Index Sampling Risk) – Some index-based strategies, particularly ETFs, will sample the index they are tracking leading to fewer names in the strategy. This increases the risk of not capturing the asset class rate of return. Dimensional funds typically have greater diversification in their respective asset classes.

NAV Premium/Discount Risk – A risk associated with ETFs is that the price can deviate from the underlying value of the assets so an investor might pay more than its worth to buy the ETF and might receive less than its worth to sell the ETF. This is especially prevalent during times of high volatility and for asset classes that are more illiquid (where trading costs exceed the benefit of arbitrage).