FINC460 - Dimensional Fund Advisors

Once you read the DFA case, provide answers to the following questions:

1. Discuss DFA as a fund and as a business. How does it add value for investors? What are the pros and cons of the passive approach?

2. What are the Fama-French findings? Do they make sense? Should we expect small stocks to outperform large stocks in the future? Value stocks to outperform growth stocks? What did Fama and French discover about the CAPM and beta? How do you reconcile the empirical findings with the CAPM theory?

3. Discuss DFAs trading strategy. How does it work, and what are the costs and benefits? Can DFA keep this competitive advantage in the future? Why dont competitors emulate DFAs approach?

4. What are DFAs products? How do DFAs new tax-managed strategies work? Is the tax managed fund family likely to be successful on a broad scale, or just a small niche market? What is the expected gain from DFAs tax management strategy, and what is the increase in volatility that results from it?

5. Let's see how well the tax-managed strategy will do in practice. Open HW7Data.xlx. It contains returns on portfolios of stocks sorted based on their dividend yield.

   Make some assumptions on the marginal tax rate faced by investors. For example, you could assume that capital gains are not taxed, whereas dividends are taxed at 40%. The excel file above has returns on portfolios with and without dividends (i.e. capital gains only). We can compute the dividend yield produced by a portfolio as

$$\text{Return with dividends} - \text{Return excluding dividends}$$

Compute *after-tax* returns from investing in each of these portfolios. Does this look like a profitable strategy?

In your answers, state clearly any assumptions you make. Remember, I am not looking for a full-blown quantitative analysis. If for some of the answers you find you have insufficient data, describe what you would do had the data been available.