EPISODE 28

Staying Ahead of the Curve: The History of Dimensional Fund Advisors

[INTRODUCTION]

[0:00:05.3] Benjamin Felix: This is the Rational Reminder Podcast, a weekly reality check on sensible investing and financial decision making for Canadians. We are hosted by me, Benjamin Felix and Cameron Passmore.

Today was an episode that we have been looking forward a long time. We had Brad Steiman who is the Canadian Head of Financial Advisor Services for Dimensional Fund Advisors.

[0:00:25.1] Cameron Passmore: Dimensional now manages in excess of 700 billion worldwide and I believe in Canada alone, 15 billion or so.

[0:00:31.4] BF: Yeah, Brad said 15. Obviously, we talk about Dimensional a lot, we use their products a lot. Having someone from Dimensional is kind of like easier said than done because they've got a strict compliance department and legal processes for all that kind of stuff but we were lucky enough to get approval which was awesome.

[0:00:46.5] CP He went through a lot of the basic foundational principles of the firm, their relationship with academia, relationship with the advisory community, why they're structured as mutual funds and not ETFs.

[0:00:56.3] BF: Yeah, it was a good episode but it was a long episode so we're going to keep the intro short. Enjoy the episode.

[INTERVIEW]

[0:01:06.2] BF: Welcome to Episode 28 of the Rational Reminder Podcast. Today, all of our guest are special I guess but we have a guest today that I'm actually excited about. It's Brad Steiman who is the Head of Financial Advisor Services for Dimensional Fund Advisers Canada.

Brad, welcome to the podcast.

[0:01:21.3] Brad Steinman: Thanks for having me Ben.

[0:01:21.7] BF: I know I already said this but we're very excited to talk to you, Brad. We talk about Dimensional a lot on the podcast, so this is a great opportunity for us and for our listeners. Brad, you joined Dimensional in 2002. I'd say it's safe to say that you were ahead of the curve in terms of investment philosophy.

I mean, 2002 index funds were nowhere what they are now. What attracted you to Dimensional back then?

[0:01:45.5] BS: Boy, what attracted me to Dimensional? I probably have to go all the way back to studying finance at UBC, this is probably when you can play the background harp music because I'm going to reminisce a little bit here but in all honesty, I was studying finance and when I first came across Fama's research on market efficiency, you know, a lightbulb kind of went off.

Similar to how Rex Sinquefield describes having an epiphany in Merton Miller's class at the University of Chicago but that's where the similarities end between Rex and I, you know, Rex was learning directly from the thought leaders themselves, you know, much earlier than I was, he went on to cofound Dimensional with David Booth.

Unfortunately for me, I was getting it second hand at the University of British Columbia and when I graduated, despite how much these ideas resonated with me, I didn't know that they were being applied anywhere in practice so –

[0:02:34.3] BF: Amazing.

[0:02:34.4] BS: Yeah, I had no idea.

[0:02:35.6] CP I've known you for 15 years, I never heard that story before.

[0:02:37.9] BS: Yeah, I did what most finance graduates would do at the time, I went to work for a traditional money manager, not knowing any better and luckily for me, that firm acquired

Dimensional's largest financial advisor client at the time, based in California and I relocated from Toronto to Los Angeles shortly after that. I didn't know anything about Dimensional but I had to get up to speed pretty quickly, that firm had their entire portfolio invested with Dimensional. I think even back then, it was in excess of a billion dollars.

I had to get up to speed and part of that process was attending, at the time what was called an introductory conference which I know you two guys have been to in various iterations and at that event, I had a few 'aha' moments. The first one for me was when Gene Fama Jnr. gave a presentation and he showed a slide that had the results of traditional active managers and how they follow a normal distribution, skewed to the left by fees and expenses.

He explained how, you know, the average investment experience has to be the market return minus fees and expenses because if you add up all investors, they are by definition the market. You know, Bill Sharp's arithmetic of active management which to us now just sorted, no big deal but back then, to me, it was a real 'aha' moment.

[0:03:58.7] CP What year was this?

[0:03:59.5] BS: This was beginning of 2000, maybe late 1999. It took me right back to school and learning about these ideas when I was studying finance and I got really excited about it. The second aha moment from that conference was totally different, it was when Dan Wheeler who started the financial adviser business Dimensional, stood up to kick off the conference and he said, if you can find someone who does what Dimensional does better or cheaper you have an obligation to use them.

Because you don't work for Dimensional, you work for your clients. If you're a fee based adviser like we were back then, you have no incentive to do anything but give your best advice and I was like wow, that's really cool. Now, to your audience, not from this industry, that may not seem like much of an aha moment like of course, that's the way it should work but coming from Canada at the time where the market was still predominantly commission based product sale oriented, there were all kinds of incentives to sell different products.

You might even call some of them conflicts of interest, to hear that just spelled out so clearly, to me, it was like well, of course that's the way it should work. What really resonated more than anything was just how much confidence it took to stand up there right at the beginning and just lay it out there. Wow, this guy must really believe that their solution speaks for itself and I got really excited about that.

It didn't take long after that when you know, I decided, I don't want to be just a client of Dimensional, I want to work there. I made a call to Dan Wheeler, the guy I just mentioned. I said, if there's ever an opportunity to join the firm, you know, I'd love to be a part of this and his response was we like to have you but it's not a good business practice to hire people from big clients. You need to get their blessing.

I went on, called the CEO of our firm who I had known quite well for a long time. He's about 10 years older than I am and I told him I want to go to Dimensional but I needed his blessing. His response was, if you were my little brother, I'd tell you, that's exactly where you should go. You absolutely have my blessing and that's when I started and a story that not many people know which I don't know is an interest to you.

In fact, even within Dimensional, I don't know that many people are aware of this but I didn't know what I'd get paid for the first two weeks that I was there.

[0:06:27.7] CP You just knew you wanted to be there?

[0:06:29.3] BS: I was attracted to the ideas, I was attracted to the mission, the investment philosophy resonated with me, the people were a big draw. And I just assumed that they'd be fair and reasonable, it didn't really matter to me that much, you know, how much I'd be paid and it wasn't until two weeks after I started when I was called in and Dan, the guy who hired me said, "Accounting just called, they're processing payroll and they want to know what I'm going to pay you. I can't remember if we talked about that."

I said, "No, we haven't."

[0:06:59.3] BF: Classic Dan Wheeler.

[0:07:00.2] BS: Yeah, I said no, we haven't talked about that but I'm sure whatever you decide will be fine and it was.

[0:07:05.2] CP: But the power of the story, I remember this story early on when we first met you and first met the people from Dimensional, David Booth would tell a story about when the firm was founded back in 1981, it was the first small cap fund, that was really what the company was founded on, right?

The first decade did not go well for small caps. This just shows the power of the story believing in the evidence that this makes sense. Now, since coming to Canada in 2003, small caps have not been great either. Can you just talk about the impact this kind of experience with the evidence has had on Dimensional in Canada?

[0:07:38.5] BS: I think I'll start by just elaborating on the period you mentioned after Dimensional was first launched. In fact, I'll even go prior to that before the firm was even founded to provide some additional context because before starting Dimensional, David was involved in launching the first index fund when he was at Wells Fargo and then he went on to consult to institutional investors.

[0:08:00.2] CP: This is no small thing, you run over quickly but this is a big deal.

[0:08:02.9] BS: Yeah, absolutely.

[0:08:04.6] BF: Founding the first index fund.

[0:08:05.9] CP: Small cap index fund.

[0:08:06.9] BF: Small cap index fund.

[0:08:09.0]BS: He was involved in an SMP 500 index fund, Wells Fargo under [inaudible] and the management sciences group there, for institutional investors, this was like 1973.

[0:08:22.2] CP: It's not retail fund, it's the first index fund for institutions.

[0:08:24.1] BS: Vanguard was the first retail fund but Wells Fargo and around the same time, Rex Sinquefield was at American National Bank doing something similar, there were some differences between how they were designing those indexes but all intents and purposes, the were large cap SMP 500 type index funds for institutional investors.

[0:08:46.1] CP Just to make sure listeners understand, pre-Dimensional, David Booth was the creator of our creator of the first index investment.

[0:08:53.1] BS: Yeah, co creator, certainly. Then after that, he went on to act as a consultant to institutional investors and while consulting, he noticed that very few institutional investors in the US at the time had meaningful exposure to small companies, they were increasingly interested in this idea of indexing and you know, from his experience at Wells Fargo, you know, talking about SMP 500, large cap type indices and it sort of dawned on him, you know, you have 90 plus money managers all systematically buying stocks in large companies.

You know, you already own the SMP 500, it's just expensive and you don't track it very well. What about small companies? Maybe there's an opportunity there to diversify out of large cap exposure and it was initially a diversification story and it made sense, it resonated with those investors. It was shortly after that, at the University of Chicago that Ralph Barnes published his research, demonstrating that small cap stocks also had higher average returns, that added another element to the story.

[0:10:01.4] BF: He was ahead of the evidence basically?

[0:10:02.9] BS: Ahead of the evidence that small stocks had higher average returns.

[0:10:05.2] BF: But not have evidence of the basics of diversification.

[0:10:09.7] BS: Of diversification and you know, what we were promising from day one, wasn't zero tracking to an index. In fact, back then, there weren't even small cap indices to track even if you wanted to. What we promised was broadly diversified and efficient exposure to small companies.

Now, after Barnes research came out, we could also demonstrate that they had higher expected returns but those higher expected returns aren't guaranteed. As you guys know, you know, guarantees are likely to be arbitraged away pretty quickly in a well functioning capital market.

The way I think about it is, I sort of go back to the equity premium because that's something most people can relate to its pretty well established that there is a positive equity premium, you know, higher expected return investing in stocks versus something safe like a treasury bill.

You know, there's some debate around how big it is but not much debate that premium is positive and for you guys, and most of your listeners, you probably know that even though on expectations, I have higher expected returns investing in stocks than something safe like a treasury bill. I'm not going to get it every year. I'm not going to get it every five years. Maybe even 10 years, you know? Over periods like that, even though the odds are in your favor of earning higher returns and the averages are positive, there's no guarantees, that's just the nature of investing and the same thing applies when you think about small stocks versus large stocks.

I think it was a period of about seven years after Dimensional started that it was the worst period in history for the performance of small stocks versus large stocks. But those clients was early institutional investors, you know, they may have been disappointed in those results, everybody wants higher returns than lower returns. You know, if you can get them but they weren't angry and the reason why they weren't angry was they knew going in that periods like this can happen, you just don't know when they'll occur.

As a result, you know, I wasn't at the firm then but David and Rex and company were able to grow the business from zero to seven billion dollars over that period. Incidentally, those same strategies, even including that initial seven year period now have a 37 year track record of not only outperforming large caps stocks but also small cap indices. The clients that stuck with it were definitely rewarded in the end and so I think the moral of the story here is that having the right expectations is very important. And as David Booth says, even to this day, the most important thing about an investment philosophy is that you have one you can stick with.

Coming back to the second part of your question which was about how that relates to our experience in Canada. You know, the same principles still apply to this day. As you pointed out, you know, since we started in Canada, a value has had a tough run, more so than size but just like the early experience in the US, we've grown from zero to 15 billion dollars because our clients understand the approach, they know what to expect and another element that I think is different about our Canadian experience is because it occurred much later in our evolution, our strategies pursue multiple premiums.

You know, not just small cap stocks or the size premium, we're also looking at value or low price stocks and more recently, profitability and there are many benefits to integrating multiple premiums, one is that those periods of under performance aren't as extreme. Because it's pretty rare that none of the premiums materialize over the time frames we're talking about, even though it's been a challenging time to be a value investor, if you look at the returns of our core equity funds after accounting for fees and withholding taxes.

You know, you're not far off market returns. Even though we expect more, that outcome alone is pretty good when you consider the performance studies show that the vast majority of money managers aren't going to be market returns after fees and expenses.

[0:14:28.4] BF: Right. You mentioned multiple premiums and that ties in really well with one of the other questions I want to ask you. We, as practitioners who are using Dimensional products a lot, often hear comments from either other firms or from our clients that say, well, I saw this factor, this piece of research and Dimensional is not using it or doesn't look like they're using it.

In reality, I mean, Dimensional's got a huge research group, is there anything that Dimensional has not looked at?

[0:14:55.5] BS: Well, it's hard to say we've literally looked at everything but I do think it's safe to say that we're on top of all serious academic research that's out there. We're continually conducting our own internal research. You guys know there's more than 80 people, 19 of whom have PHDs in various disciplines acting in that capacity within Dimensional. That's not counting our academic consultants who they interact with.

Part of our job is to look for research and understand what will produce robust outcomes for our clients. I think you guys well know that there are literally hundreds of so called premiums that have been identified in the academic literature and it's important to look at those premiums with some degree of skepticism for a couple of reasons. The first reason is that you know, competitive capital markets are very good at incorporating information enterprises.

It shouldn't be easy to identify all these factors that "beat the market." The second reason, you need to be a little bit skeptical is the problem of data mining. You've heard me say that you torture the data long enough, it will confess to anything because there are literally thousands and thousands of academics and practitioners all looking at the same data and patterns will be discovered that just happen by chance.

My favorite example - this was an academic paper that was you know, sort of written tongue and cheek, I have to make that clear but the relationship was established between sun spots and stock market returns. That's obviously just data mining.

[0:16:37.8] BF: Yeah, there's no reason for that expected returns.

[0:16:40.4] BS: Obviously. It's an extreme example and those or that type of example is not what you need to be concerned about because we don't have a solar activity fund, nobody else has a solar activity fund, you know, what you need to be concerned about our other premiums or factors that may have also just been discovered by chance but might have more plausible explanations. The way we look at the research, whether it's coming from the academic community or work we're doing internally is to set a really high bar before we elevate something to the level of what we call a dimension which is what we would use in managing our portfolios.

If you just give me a minute, I thought I should sort of outline those criteria.

[0:17:25.9] BF: Makes sense, yeah.

[0:17:26.9] BS: Just so you get a sense of how high that bar is. The criteria, you know, first and foremost, it has to make sense, there has to be a sensible explanation for why you're seeing what you see in the data. An example again maybe an extreme example of something that might not make sense, is I recall in the late 90s, seeing some data that showed if you invested only in companies that started with the letter M, you would outperform.

Well, that doesn't make a lot of sense, you would have been disappointed had you followed that strategy because I think subsequent to that, it turned out to be the letter A, but you know -

[0:18:01.5] CP Or G.

[0:18:02.5] BS: Well, they changed the alphabet. They'd be in the letter A but it's got to make sense, you know? It sort of goes without saying, but it's the first in our criteria.

The second thing we look for is that it is persistent through time so let me elaborate on that a little bit. Really, what that means is you want to make sure that it's not a period specific outcome. If the research was conducted, looking at a certain time period, you want to look out a sample at an entirely different time period to see that it persists there as well.

The next thing you look for which is very similar to persistence through time is that it is pervasive across markets. In many cases, the research begins by looking at the US equity market, that's where you have the best data, longest time periods and so on but you don't want to stop there. There's also really good international data now and you can look at those international markets as a completely independent data set. Test out a sample, see that it's pervasive across markets.

The next thing is, we wanted to be robust and robustness is, you know, this is a little bit more nuanced but it's just making sure that if the results are highly sensitive to how the experiment was run and if you change a variable a little bit, the whole thing falls apart like a house of cards. Then it's not robust and not necessarily something you want to build an investment strategy around.

Then the last thing is, to ensure that it's cost effective to capture in a live portfolio. Another saying is, academics don't pay transactions cost and it's because they're looking at results generated in a computer and you want to be sure that you can actually profit and realize those results in a live portfolio where you have to account for market friction.

To answer your question, I think it's safe to say, you know, although we're not necessarily looking at everything, we're on top of all the serious academic research but we're setting a high bar and this high bar, these criteria that we apply are there so that we can increase our confidence that what we've seen in the data historically is likely to persist going forward.

[0:20:16.0] BF: One of the factors that has gotten a lot of attention and there's been a lot of work done on it and a lot of other firms are implementing products based on it is quantitative momentum. We've had a handful of client questions about that over the years where people say okay, the data on this looks pretty good, why aren't you guys looking at it, why aren't you using it in our portfolios?

Obviously, Dimensional is not using it in their products. Can you talk a little bit about the decision to avoid momentum?

[0:20:41.1] BS: Sure, well I would sort of go back to those criteria that I just described and there's a couple in there that give us pause when it comes to momentum. You know, the first being that it lacks a sensible explanation. We don't know why it exist. It's arguably the most studied anomaly in finance and yet remains poorly understood.

Now, having said that, explanations have been proposed explaining but they're not particularly satisfying because you know, some suggest it's investor over reaction, other suggest it's investor under reaction. Take your pick. But I recall seeing a presentation by Robert Novy-Marx, one of the academics who we work with and he was sharing some research on momentum and he demonstrated that if you looked – momentum is buy what's done well recently.

Avoid or sell what's done poorly and he looked at if you sorted on what's done well six to 12 months ago, you know, bought what had done relatively well, six to 12 months ago and sold what had been relatively poorly six to 12 months ago, you did far better than if you just looked at the past six months. The moral of the story there, the point he was making that if investors are indeed over reacting or under reacting, they're waiting six months to do it.

It just doesn't make a lot of sense. The second concern we have is whether it's cost effective to capture momentum in a live portfolio that, as I said, has to account for market frictions because momentum is a short term phenomenon. It decays rapidly, so it requires a high level of turnover in many cases several hundred percent. So the question is whether such a high turnover strategy can survive implementation cause.

And on that note, we recently did some research and examined the performance of live funds trying to capture momentum. It's available online publicly if your listeners want to go dig it up and as you'd expect, the turnover was quite high but despite the majority of those funds having experienced a strong momentum premium, the vast majority were not able to convert that into above market returns after fees and expenses. So betting on momentum, in other words trading a lot to try and capture it remains questionable.

On the other hand, we don’t necessarily want to bet against momentum. So at Dimensional, we account for it when we trade. And what do I mean by that? Well, consider a portfolio that pursues the value in size premiums. How do companies become small? Does their price go up or down?

[0:23:24.0] CP: Down.

[0:23:24.4] BS: Their price goes down, that’s how they get small, right? Very few companies are born small. They become small. What about value, how do companies become value stocks?

[0:23:33.3] CP: The price goes down.

[0:23:34.3] BS: They’re by definition low price stocks. They become value stocks when their price goes down. So portfolios that are pursuing size and value premiums systematically will buy companies that have fallen in price and sell companies that have risen in price and that is exactly the opposite of what momentum would tell you to do. So that would be betting against momentum.

So instead if a portfolio wants to buy more of a company that’s in downward momentum. Or sell some of the company that’s in upward momentum, we just wait until the momentum dissipates. Again, it decays rapidly and that way we aren’t betting against momentum but we are necessarily increasing turnover to try to capture it.

So Ken French uses a good line to sort of sum this all up by saying, “Momentum doesn’t cause us to trade but it may cause us not to trade.”

[0:24:29.0] CP: Fascinating. So I said that the Dimensional ignores momentum and that that’s not accurate. It’s being used in trading in portfolios.

[0:24:35.7] BF: It's used in decision making, right? As you manage portfolios but there's no specific momentum factor portfolio.

[0:24:42.0] BS: That's correct. I mean we are definitely considering momentum as sort of a competing premium the way I described to size and value but with a very different timescale. Size and value tend to be longer terms effects. Momentum is very short term so you have to account for those differences in the time scales and manage those tradeoffs accordingly.

[0:25:03.0] CP: So I have another factor question for you. So a couple of years ago, you added a profitability to the portfolios and can you talk about that decision and what is the process of identifying and implementing new factors. That was a pretty big decision to make that across the board decision, correct?

[0:25:19.1] BS: Yeah, I mean those big changes and big ideas, new factors whatever you want to call it they don't come along very often because of what I said earlier, sort of the skepticism. They shouldn't come along very often. You know the market works pretty well at reflecting information and security prices.

So it shouldn't be easy to identify new factors that add anything over and above the factors that you're already considering and managing your portfolios but the process of identifying them which was your question I believe -

[0:25:48.9] CP: The process then the implementation side.

[0:25:51.1] BS: Yeah, I mean if we think about the process to begin with it's basically applying the criteria that I outlined. If it's based on academic research that's in the public domain, the first thing you need to do is replicate the results internally. You just can't take them on face value. If we can replicate those results then we want to stress test the data ensure that it's robust as I said earlier. That the results aren't overly sensitive to how the experiment is conducted. How variables are specified or the time periods or markets that have been studied.

Once that's been done, if a factor or a premium makes sense and it's empirically robust then we consider implementation. Now implementation requires understanding the competing nature of premiums, how they interact, how they behave over different time scales as I just eluded to. That way you can effectively balance the tradeoffs required in managing a live portfolio.

And that's at the end of the day, I believe that's Dimensional's competitive advantage because a lot of the research is in the public domain but it is how the ideas are implemented that sets us apart. So that process when it comes to the identification of new factors which you were taking about, it relies heavily on our internal research team who collaborate with the academic consultants. But ultimately, those big decisions roll up to our investment research committee.

And that is co-chaired by Gerard O'Riley our co-CEO, and Ken French and on that committee are David Booth, Gene Fama, Robert Merton he's our resident scientist and also a Nobel laureate. Robert Novy-Marx who I just eluded to a while ago and then several of our internal researchers and senior portfolio managers.

[0:27:39.7] CP: It is not a bad lineup.

[0:27:40.6] BF: Not a bad group to take advice from I guess. Brad, you just eluded to implementation being one of Dimensional's advantages and we definitely agree with that. Part of that implementation has been the choice to use the mutual fund structures opposed to ETFs.

Now ETFs has been sort of the hot topic. That is what everyone is interested in and when you talk about an index fund people think ETFs. Can you talk about Dimensional's decision to go to mutual fund route as opposed to the ETF route?

[0:28:05.1] BS: Sure, when you say ETFs are the hot topic, I think there's three reasons for that. First reason is the increasing appeal of lower cost compared to conventional, let's say active mutual funds. The second is the broader adoption of what I'll call systematic approaches to investing like index funds rather than stock picking and market timing, which is sort of the traditional approach and then the third is tax efficiency and if you think about our funds, we already have those attributes.

So what you give up by not structuring as an ETF is intro day liquidity which for our clients as long term investors that's not a huge concern of theirs. What you gain by not structuring as an ETF is greater flexibility and implementation. So you can continuously manage the portfolio instead of just reconstituting it periodically and why is that important? Well it is important because prices are changing every day. That should influence what you want to hold, every day.

But it also allows you to trade more efficiently as you can take advantage of the natural liquidity in markets instead of having to do all your trading on a few days. So kind of an analogy that some people listening might relate to as it’s a lot easier on the body to run one mile a day for 26 days than it is to run a marathon. It’s much easier on the portfolio to trade a little bit of every day than it is to do all of your trading on one or two days each year.

[0:29:43.0] CP: I hadn’t thought about that, [inaudible] in trading in ETFs versus a mutual fund. If you have to trade around the reconstitution and the creation of them.

[0:29:52.0] BS: Yeah, when the index that the ETF is tracking gets reconstituted -

[0:29:55.6] CP: Oh yeah, I see that but for you is that adviser to the pool, that’s how you trade - would it be different in an ETF environment versus a mutual fund environment?

[0:30:02.5] BS: It would be different, yeah. You don’t have the same level of flexibility. Now having said all of that, you know part of our job is to continually monitor the investment landscape and make sure that we’re considering investment vehicles that make sense for our clients and what we do in many cases is to list a feedback from advisers like you guys in that regard.

[0:30:21.7] BF: And we’ve never asked for an ETF version of a Dimensional fund.

[0:30:25.0] CP: No, operation funds are also good, you get net asset value there’s other advantages so.

[0:30:29.4] BS: Yeah, I’ve only touched on a few and what I am sure of is if you guys thought there was something better you’d be asking me for it.

[0:30:36.3] BF: Yeah, another decision that Dimensional has made from day one in dealing with advisors as oppose the institutional world is you select them in terms of which advisors have access to your funds. It is a very deliberate decision. Can you talk about that decision?

[0:30:51.5] BS: Yeah, we get that question a lot because it's pretty unique. I am not aware of any other firm in the industry - not just in Canada that approaches it the way we do and I think first of all, you have to recognize the nature of our strategies and that they are broadly diversified. In many cases, owning thousands of securities and that level of diversification is important. It increases the reliability of outcomes and it also allows for more efficient trading.

Because you're given flexibility as a result of that many securities being candidates for a portfolio. However, it also requires that for most investors you have to co-mingle your assets with other investors to achieve the economies of scale necessary for that level of diversification to be cost effective.

[0:31:40.0] CP: That's the key.

[0:31:40.9] BS: And that was true even early on with our institutional investors when that was our entire focus, you know they understood why co-mingling was necessary. They also understood that co-mingling works when investors behave responsibly. So a foundational belief of the firm is that investors should be focused on the long term but if you chase performance and you move in and out of funds, it creates a performance thread for the long term investors.

And it's the long term investor that we're focused on. So when we started working with advisors, start late 80s, I believe it was 1989 we did it cautiously. We wanted to ensure that we were working with advisors who shared our beliefs, who would behave in ways that benefited all investors and that's why we have taken the approach we have to working with the advisor community.

[0:32:34.8] BF: So Brad, Dimensional's story which you talked about briefly at the beginning of the show but the story is amazing just in terms of who's involved and how everything progressed. Do you personally, you have been there for a lot of years now. Do you personally have any favorite stories from your time at Dimensional?

[0:32:49.6] BS: That's a tough one because as you said, there are a lot of great stories. Many of them are part of the Dimensional lore so to speak and the one that I still think is really cool is just how when David and Rex were starting the firm, they were meeting on campus at the University of Chicago and they were told they needed an independent board of directors and the lawyers told them that and the only people they knew were academics.

So they walk down to the business school and in his office was Merton Miller and asked, "Mert, hey. You know we are starting this firm. We need a board of directors."

[0:33:25.6] CP: It's crazy, that's completely crazy.

[0:33:27.8] BS: Not only that, they said, "We can't pay you anything right away but you know, we'll see how things go," and Miller was on board and David's tells this story. He says once you got **[0:32:49.6]** Miller on board, you know people took note and [inaudible] was the next one in line in the office next to him and he said, "Sure I'll be involved." And Fama was involved from the beginning because a lot of what David and Rex set out to do was apply his ideas in practice.

I think it's cool because it's easy after these people have won the Nobel Prize and become big names to ask them to be involved in the firm but they were asking them when they were still relatively unknown.

[0:34:07.4] CP: They weren't big names back then.

[0:34:08.4] BS: They weren't big names back then and it was almost happenstance, you know how some of them got involved early on so I think that's a good one. Another favorite of mine which is less well known. I am not even sure if you guys have heard me tell this story but in 2018, as you guys know we do a lot of conferences, educational events for our clients whether they're institutions or advisors. In 2018 we had 65 events designed just for financial advisors.

Educational events, conferences, those types of things. And almost 5,000 participants and we were conducting those events right from the beginning. When we started the advisor business in 1989, we hosted our first educational event, our first introductory conference and Dan Wheeler rented hotel banquet rooms that had capacity for hundreds of people. In some cases, five, six hundred people and less than 10 would show up.

So times have certainly changed but you know there was a vision for the future of where the independent advice channel was going but it didn't have success written all over it early on. And that one last one, you asked for me personally so I will just tell you one that I guarantee nobody has heard. Very few people within Dimensional have heard because it is a personal story.

[0:35:29.5] CP: The secret will be out soon though.

[0:35:31.1] BS: The secret will be out soon. I won't mention any names but when we were doing our due diligence prior to starting the business in Canada, I was meeting with various people from the industry. Just sort of getting their impression, advice, that sort of thing including in one case the CEO of one of the biggest fund companies in the country. I won't mention which company and the feedback was pretty consistent. It wasn't about the, "Ah that investment philosophy doesn't make sense," or anything like that.

It wasn't about investment philosophy but once they understood how we were planning to do business where we were sort of trying to replicate our approach to doing business with advisors in the US but apply it to the Canadian context. Which essentially meant we're not going to pay any commissions. So we only want to work with fee based advisors. We're not going to own our own distribution so won't buy dealers with an army of reps that we can incent to sell our products.

We are not going to do any traditional advertising and that type of marketing. We're not going to grow by acquiring other firms, which is how many companies in our market have become as big as they are. I was basically told that's crazy that will never work here. I had an obligation to share that feedback with David Booth of course and to his credit, he just sort of smiled and nodded and he said, "Well we're going to give it a shot anyway."

So I think it's safe to say that if anything, the market has increasingly moved in our direction since then and it has worked here, as a result.

[0:37:08.5] CP: It has very beautiful. It's been a great relationship certainly for us with you and Dimensional. So we started out this interview talking about this journey that you started at UBC.

So I have a different question for you one that we kind of asked this sort of question to all of our guests.

So at a recent conference that we were at, you spoke about happiness and I know you are very passionate about this. Can you talk a little bit about the transformation that you've gone through over the past few years?

[0:37:34.1] BS: Oh that is an even longer story than what attracted me to Dimensional but I will try to keep it brief because you're right, it is a passion of mine. It is something that I am interested in. I have been speaking about a lot lately because about five years ago, there were events in my life that were creating a lot of anxiety and I had to do a lot of soul searching to sort of my nature. I started reading a lot during that process and the first book I read was Dan Harris's book, *Ten Percent Happier.*

And for those who haven't read the book, Dan essentially also experiences some anxiety, tries to find what will work for him in dealing with it. Coincidentally, it is a sign by Peter Jennings to cover the religion beat. So he is meeting with religious leaders all over the world from the Dalai Lama to Mormon leaders. It doesn't really speak to him personally although he makes many good friends and forges relationships there.

That sort of segues into the self-help culture that he investigates, talking to gurus like Deepak Chopra and Eckhart Tolle and so on and that doesn't do it for him and he stumbles across meditation and he was a total skeptic as I was but he gives it a try and he finds it's the only thing that works and the reason he writes the book is he feels that meditation suffers from a massive PR problem. You know you think of burning incense and crystals and chanting and wearing robes and that sort of thing.

But when in reality, there's a lot of science to it. It is really compelling, the Marines are doing it, professional athletes do it, Fortune 500 CEOs do it and I remember one line from the book, one paragraph where he said if you go back to the 50s and 60s when physical fitness wasn't mainstream and you said to your colleague at work, "You know I'll meet you at six, I'm just going to go for a run first." The response you get would be something like, "Who's chasing you? What do you mean go for a run?"

Now, it's just physical fitness. It's pretty main stream. Nobody would bat an eye if you made that statement and his hope is that in the future, you could make the same statement, "Yeah I will meet you for a drink at six. I'm just going to meditate first." And you wouldn't get puzzled looks. It would just be kind of a normal thing. So that was my launching point into doing more reading and really getting into the positive psychology literature which I have read quite a bit about.

And I'll just quickly summarize two big takeaways from that literature, if you don't mind. One, I've learned what doesn't make you happy and what doesn't make you happy is stuff, money, power, fame, status, those kinds of things don't make you happy because of adaptability. We adapt to our new environment. So once we get those things, we end up what psychologist call the hedonic treadmill and we find ourselves no more happier than we were before.

So many of us respond by going, "I guess I need more this wasn't enough" and you're just adding up on that never ending treadmill. So I've learned what doesn't make me happy but I also learned what does and I subscribe to Martin Seligman who's I call him the Gene Fama of positive psychology, sort of the father of positive psychology and his wellbeing theory and his wellbeing theory is based on five elements. It is a five factor model.

The acronym is PERMA and it stands for Positive Emotion, so what we feel. Which you can increase by meditation, mindfulness, gratitude, acts of kindness, pursuing self-concordant goals, those kinds of things. Engagement, being engaged in what you're doing which is when time stops and you're at one with the music, where there's almost no cognition or no emotion. It is almost the opposite of Positive Emotion from that standpoint and in its highest form that is known as flow.

There is a lot of research into being in flow and how that makes us feel better, happier or increase our wellbeing. The R stands for Relationships or having authentic connections with other people whether it's your community, your church, your workplace, just your social life that sort of thing, having authentic connections with other people will increase your wellbeing. M is for Meaning and Purpose, so belonging to or serving something you believe to be bigger than yourself.

And then the last thing, A is for Achievement because we want to accomplish something, we want to win. We want to master things simply for the sake of achievement and if you can focus on those five things, on increasing your PERMA, forget about the stuff, so to speak, you will increase your wellbeing. So that's been a huge mind shift for me personally.

[0:42:28.2] BF: Science based approach to happiness, I love it. Brad, this has been an excellent interview and discussion. So thanks a lot for coming on the podcast.

[0:42:35.2] CP: Yeah, we really appreciate it, Brad.

[0:42:36.7] BS: Yeah, you're welcome. Thanks for having me.

[END]