EPISODE 43:

Life at Dimensional: The Constant Pursuit with Dave Butler

[INTRODUCTION]

[0:00:05.8] 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.

You're in Australia, as anyone who listens to every single episode of the podcast would know, or I guess if they at least listen to the one where we talked about the fact that you're going. One of the things that you got to do while you were there, which I think it's really cool.

You got to interview Dave Butler, who is the current CEO of Dimensional Fund Advisors. Like dimensional or not, like us talking about it or not, they are a massive asset manager with an unbelievable history connected to the academic world of finance. Like it or not, the interview was fascinating.

[0:00:50.0] Cameron Passmore: Yeah. He was a real treat to spend time with and has been there since they're a very small company, has been part of their growth story going back to 1995. He's been there, seen the growth and has spent a lot of time with the academics and knows these people and the stories behind it. The history behind this company is unreal.

[0:01:12.7] BF: It wasn't even just that. He had insights on investing, had insights on Dimensional, but he – I mean, he runs a company that has 1,500 employees globally?

[0:01:21.3] CP: Insights on leadership were amazing.

[0:01:22.7] BF: That's exactly it.

[0:01:24.4] CP: He's an interesting guy. He was very straightforward. We got on I think a good zone of conversation and the hour flew by, so I think it's a really fascinating listen from a leader of a great asset management company.

[0:01:36.4] BF: Yeah. I would say it's definitely worth listening for his insights from all different perspectives.

[0:01:42.3] CP: It is a bit longer than usual. I think it's well worth the time.

[0:01:46.9] BF: I mean, for our little old podcast, it's a pretty good guest.

[0:01:49.4] CP: Oh, it's a big guest. It's a big deal. Now he's a genuine guy, super nice, had all the time – not all the time, because he had a meeting to get to, but he was in no rush. “Take the whole hour, I'm fine. Ask me anything you want.”

[0:02:02.0] BF: Yeah. It was a really good conversation.

[0:02:03.8] CP: All right, have a listen.

[EPISODE]

[0:02:14.2] CP: This week, we have a very special guest joining us and I'm super thrilled to be able to spend some time with you.

Dave, welcome to the Rational Reminder.

[0:02:22.3] Dave Butler: Thank you, Cameron. I appreciate it.

[0:02:23.5] CP: My first question, as you know we use Dimensional funds with all of our clients. I'm curious, how would you describe Dimensional funds?

[0:02:32.2] DB: I would describe Dimensional as a firm that's really in the pursuit of delivering a really great client experience. When I joined the firm 25 years ago, that was really what stuck out to me was this persistent pursuit of truth, of trying to find the right answer in the capital market space and then obviously, delivering a client experience to not only meet expectations, but exceeded expectations as well.

[0:02:57.2] CP: You have a very impressive athletic career and your story of how you ended up here, I find fascinating. You're actually drafted by the Celtics right back in ’87?

[0:03:05.8] DB: I was drafted by the Celtics in 1987. They actually had a strike the year I came out. Normally, basketball players would go to the rookie camp and have a chance to try out and see how they perform versus the veterans. That year they didn't have a rookie camp, so –

[0:03:22.5] CP: You would’ve had a shot at the NBA? Pretty good shot?

[0:03:24.8] DB: I would’ve had a shot at the NBA. Yeah, yeah. I was sitting there basically at home on my mom's couch waiting for this chance to go to the camp and I got a call from my agent the night before saying that the strike was on and there's a good chance the strike was not going to end for the whole year.

[0:03:40.5] CP: Amazing.

[0:03:42.8] DB: I was dumbfounded as to where I wanted to go, what I wanted to do. The next night he called up and he said there was a team in Istanbul, Turkey that had seen me play in college and wanted me to come and try out.

I was a 22-year-old kid and I had never been to Turkey and they were going to give me a round-trip airfare and a hotel and workout for four days. I thought, I'm going to be at home working out for four days anyway, why don’t I go and see Istanbul?

I went over there and I was in the best shape of my life, because I was prepared for the Celtic camp and I had a great tryout and they offered me a contract that was basically double the size of what I would have made as a rookie in the NBA. I had one of those dilemmas in front of me that said, “Well, do you wait for your dream and go to the NBA, or do you just take this contract in Turkey?”

It really wasn't that I was going for the money. It wasn't that at all. It was more of the fact that it felt that the positioning on the strike was it wasn't going to end and I would be sitting there the whole year not working on my game and getting my skills better and better. My thought was I'll go to Turkey, I'll play a year. I'll have to be the top scorer. I'll have to learn to score at a more

consistent pace and then I'll come back to Boston the following year even better and come back and make the NBA.

[0:04:52.8] CP: It didn't quite go that way.

[0:04:54.1] DB: Didn't quite go that way. Probably about three quarters away into the season, I was at a practice and we were doing a drill, an up and back drill and where you sprint to one line, you backpedal to the next line. When I was backpedaling and I took off to the next line in front of me, I felt this snap in the back of my Achilles and calf. Sure enough, I had basically torn my – what they call it gas rock, which is the muscle between the calf and the Achilles. That knocked me out for a handful of weeks.

[0:05:23.0] CP: Did you know then your career wasn't going to have that path you were expecting?

[0:05:26.1] DB: No. When you're 22 and you're big and strong and fast and you think you're invincible at the time. I thought to myself, this would take me a few days to get over. Unfortunately in Turkey, there's only one what they called import, one American per team. I was the only American and I was the main scorer and rebounder and all that stuff. They rushed me back onto the court probably before I should have. The doctors, after the fact, tell me that the muscle didn't basically just reacted to that and formed a lot of scar tissue in my calf and Achilles.

I came back. I finished out the season. Came home for the summer and my leg was not what it was. I could feel it and I wasn't able to train as well as I could have. Long story short, as I end up the following summer, Celtics wanted me to come back to camp, but I knew I was about 60% of what I was. I got an offer in Japan and went over to Tokyo and spent the next year in Tokyo thinking I'll just again, try to rehab my leg and get back to a 100%. That didn't happen either.

Played out the season, which was great. Then I went back to the US and thought I need a year off to just to try to get my body back. I had started my MBA at Berkeley and went back to finishing my MBA. That was my finance background. I finished that up.

[0:06:44.3] CP: Then you moved to New York at some point, correct?

[0:06:46.7] DB: Quick story on that is I end up finishing up the MBA. I had interviewed with a couple investment banks at the time and I had some – I thought I had some pretty good interviews, but I didn't get an offer right out of the chute. I decide I wanted to keep playing. I wanted to give it a shot. I didn't want to lose that dream. Give it one more shot.

I went down to a professional summer league and Los Angeles got a offer from a team in England. I thought to myself, “I'm not the player I was. I'm not going to make the NBA, but I need to finish this dream of –”

[0:07:14.2] CP: The dream lives on.

[0:07:15.3] DB: The dream was on, so you have to do it. I went over to Birmingham, England and I was there for about a month and it was very immediately clear to me that my leg was not better. Again, my game was probably 60% or 70% of what it was. I knew that the dream, the basketball dream was over.

[0:07:33.1] CP: How did you bridge from that to finance? Was the bridge obvious to you based on your MBA?

[0:07:37.0] DB: No. Just like everybody. Athletes are put in a position where you spend all of your time doing something, i.e. your sport. Then you're suddenly – unlike most people who retire at 55, or 65, or 75 or whatever it is, you're retiring at 25, or 30 if you're lucky and 35 if you're really lucky. Most advisors, or most athletes I know have a real tough time transitioning out of their sport, because that's really all they knew.

Unfortunately or fortunately for me, luck was involved in the sense that I was in England, I knew my leg was not functioning like it should. I had happened to interview with a couple investment banks the prior summer. One of them called my mother out of the blue and said, “Hey, we've got a position on the desk in New York.” I was in Birmingham, I got that call from my mom. I called the investment bank and told them that I was interested. They said, “That's great. Well, can you start on Monday?” This was Saturday afternoon.

I walked into the coach and said, “Look, I'm a finance major in school. This is a dream job at that point being on Wall Street. I've got to take this job.” I basically told him that I was going to head back to the States.

Caught a flight back to New York on Sunday night and my younger brother Greg who played basketball at Stanford and he end up playing with the Knicks for a couple years, he was in New York at the time. I landed in New York. I went over to his apartment. He's 7-feet tall, so a little bigger than I am. I borrowed a suit on Sunday night and showed up at the job, my investment banking job on Monday morning and that was my transition.

People always ask me about what was your transition from an athlete to business? It was basically about 24 hours.

[0:09:20.1] CP: I was also curious, because I can see here the drive in you wanted to keep that dream alive, but you're in a team sport. Then were you a natural leader when you worked in that first team in Turkey, be being American on that? I'm curious how this melding of team, drive, leadership, led you to where you are today.

[0:09:38.6] DB: Yeah. So many lessons from sport that I have been able to apply in life and in business. As I look back in my sporting career, it shocks me. I didn't realized what lessons I was learning along the way.

As I look back and as I have to apply some of those lessons now as a CEO, it's very clear to me that what you see in sport is a very short microcosm of a season, or a business, cycle or career and a lot of the things that are necessary to do well come in a real quick fashion in sport. I was a captain at University of Cal, at Berkeley. As an American in Turkey, you had to be the top scorer and you had to be the top defender, you were the lead player.

[0:10:23.3] CP: You needed a team to be that.

[0:10:24.7] DB: Yeah, absolutely. My view as you know has always been it's all about team, it's not about me, it's about the group and how the group functions in totality. That's the goal. I mean, any great team – I've been on teams with great talent that have not won and have been really poor and have disappointed people.

I've been on teams with more average talent that have done super well and there's a camaraderie and a teamwork and an enjoyment in the craft, in the work, that comes out in spades. That shows up in win-loss records, it shows up in success and in business, it shows up in profit and culture and everything else.

[0:11:04.8] CP: Dimensional manages now well over 700 billion dollars. Who you are as a company and as an organization that we've worked with since you came to Canada 15 years ago, really goes back to the very early days.

Can you briefly tell a story of David Booth and Rex Sinquefield co-founding the firm? Then that timeline from that period in the what, mid-80s, up to the time that you joined? When did you come in? Talk about the evolution of the firm today.

[0:11:32.5] DB: Sure. Well, I think the evolution of the firm starts back in the 50s. This is Gene Fama and some of the other academics. Gene is a Nobel Prize winner. He's on our board of directors.

The academisc started looking at the academic data, at the research data. It was pretty clear that this idea of active management picking stocks and timing markets and trying to add value to a portfolio, when you looked at the actual outcome, the data that was by that time computer-based and accessible to these guys –

[0:12:03.9] CP: For the first time.

[0:12:04.4] DB: For the first time, the reality, the aha moment was these active managers who people assumed could outperform, did not. They not only didn't perform, but they had to perform basically by fees.

That was a I think an aha moment for everybody. In the early 70s Rex Sinquefield, who was one of the founders of Dimensional, he started the first index fund at American National Bank.

[0:12:27.6] CP: This was an institutional fund, not a mutual fund, right? Bogle and Vanguard was the retail fund, correct?

[0:12:32.5] DB: Correct. Bogle and Vanguard were in 1975. In the early 70s, 71 was American National Bank with Rex for an institutional product and then David Booth and Mac McQuown who's also on our board, they started the first index fund at Wells Fargo.

[0:12:46.9] CP: It's incredible. These are just ideas that were starting then.

[0:12:50.8] DB: Yeah. There wasn't any – again, no profit motive. There wasn't a business necessarily that was significant. People thought of indexing as Rex used to call it, un-American. Un-American in the sense that you weren't trying, you just were replicating a –

[0:13:06.4] CP: You're accepting capitalism.

[0:13:07.8] DB: You're accepting capitalism, which is very American. It wasn't something that was well received by audiences, because that was the nature of the business. There was big fees. Fees were paid for active management.

The idea that was research out there that showed that active management didn't add value, but they were still charging fees was not something that was well-received by the investment community. That was in the early 70s, Bogle and David Booth and Bogle were friends and a lot of the information –

Yeah. A lot of the information that they worked on at Wells Fargo, they were able to pass on to John Bogle at Vanguard.

[0:13:44.7] CP: No kidding.

[0:13:45.6] DB: There's definitely a connection there.

[0:13:48.3] CP: Both people, both individual were trying to make the world better. That was the motive.

[0:13:52.0] DB: That was the motive of it. Bogle was one of those guys, he was a protector of the individual investor. Booth and Fama and Sinquefield and these guys were, I'll call it the

“pursuit of truth.” They're trying to say, “Hey, how do access the capital markets in the best way possible, in the most efficient way possible?”

This idea that prices reflect information says that there's this thing called the market. Rex Sinquefield used to call it the great information processing machine. The idea was that the market price would move around and reflect information that would come in to the market.

That was a best predictor of actual value of a stock. One thing we used to always say is that active managers aren't stupid. They're very smart. They're very educated. They try hard. They work hard. The problem is their competition is this thing called the market. The market is really, really good at reflecting the price that we would expect for a certain set of information in certain set of news.

[0:14:49.7] CP: That is the point, right? There's so many smart participants with lots of technology. You have to beat the collective. Wisdom of that.

[0:14:58.4] DB: Again, I would say, personally, I would say it's very tough. Anecdotally, it's very tough, but then again, data, now there's 70 years’ worth of data that just says there's not an ability to do that.

That was considered to be a negative message, because if you can't beat the market, why are you in the market? One of my mentors, Dan Wheeler, always used to say that we all have capital. We should be able to deploy that capital in the capital markets and we should get a return on that capital.

[0:15:25.1] CP: Expect a return.

[0:15:25.8] DB: In the most efficient return possible. If you did that, you were going to be okay. The bad news was you can't beat the market. The good news is you can still have a successful investment experience without beating the market.

That was really the story of indexing, as if you were able to deploy your capital in an efficient way, a diversified way, a low-cost way, a tax-efficient way and you were able to then behaviorally stay in the market through up markets and down markets, you would be able to

have this experience that we really hadn't seen before in the investment space, because nobody had ever really documented the actual numbers.

[0:16:04.0] CP: Tell me about how David and Rex then decided to start with a small cap fund. Wasn't necessarily an indexing and it certainly wasn't a multi-factor story, because the factors were just being – that was before they were discovered by Ralph Bonds and then the famous Fama-French early 90s paper.

[0:16:20.8] DB: It was the first factor, and in terms of –

[0:16:24.4] CP: It wasn't academically sound fact. It was just a diversification story, right?

[0:16:27.8] DB: Yeah. The story for David Booth was that he had gone through this with Wells Fargo. They had started the first index fund. Then he had went off to become a consultant and he was talking to big pension plans, the biggest pension plans in the world. In most cases, he'd look at their holdings and they might have 40 different managers. Every manager had some combination of the same 50 stocks. He would go in and say –

[0:16:51.4] CP: Large cap.

[0:16:52.1] DB: Large cap. Yeah, and he'd go in and say, “Wouldn't it make sense to own small cap, because you'd be more diversified having both?”

[0:16:58.1] CP: It wasn't an expected return story.

[0:17:00.2] DB: It was not an expected return. It was a diversification story. When we think about today, global diversification, diversification makes sense in so many ways from a compound return perspective, but he was talking to clients about that about diversification.

He came up with this idea of a small cap fund. That was really the first Dimensional fund, which was back in 1981 the Dimensional micro-cap fund.

[0:17:24.6] CP: That’s long before you. You were playing basketball.

[0:17:27.2] DB: Yeah, I was in high school.

[0:17:28.5] CP: This wasn't on your radar.

[0:17:30.2] DB: Not even on my radar in high school. Yeah.

[0:17:33.0] CP: They started building this in their Brownstone in Brooklyn as a story goes, but it's a small cap for institutions only. They weren't even in the retail space at that point.

[0:17:40.1] DB: They were not in the retail space at all. By luck and by happenstance, the first research on small cap stock by a guy named Ralph Bonds came out right about the same time. David had already gone in and started talking about diversification. Then this PhD at University of Chicago had come out with a paper on small cap stock returns.

It turned out that small cap stock returns had about a 3% or 4% better return in the large cap stocks. David now had a piece of information, a piece of research just says small cap stocks outperform.

[0:18:15.7] CP: He didn't have the performance then, that's for sure.

[0:18:17.4] DB: He did not.

[0:18:18.1] CP: The first 10 years are pretty rough.

[0:18:19.2] DB: Right. That's the punchline of the story too was that the data that Ralph Bonds looked at was from 1926 to 1981. These guys started the small cap stock in '81, fund in '81. Then for the next nine years, small cap stocks underperformed large cap stocks for a nine-year period.

[0:18:39.8] CP: Look at the conviction that David and Rex had in the evidence, which every event I've ever been to over the 15 years, that's goes – that runs through every single story with conviction, as opposed to just looking for the hot fund, hot idea.

[0:18:54.0] DB: Exactly. It comes back to what I said earlier about meeting expectations. The expectations that David set with clients was number one, you're going to diversify, you're going to have small cap stocks in your portfolio, that's good. Number two, this data on returns, we're going to show you the return, the premium, but we're also going to show you the volatility, or the range of returns over various periods of times on that extra premium.

What we showed and what we've always shown is we might say small cap stocks return 3% more. But there are five and 10 and 15 and 20-year periods where small cap premium might not show up. That's part of the risk. It really comes down to positioning the portfolio, so that people say, “Okay, I can get diversification from small cap. I can get diversification from value today, but I also recognize that there's going to be moments, there's going to be months, or quarters, or years, or five-year periods where it does not show up.”

The longer people stay in it, the higher the percentages of the times that that premium outperforms. It has just happened that David and Rex, the first nine-year period, I think it was a large-cap was something on the order of 12% and small caps were something like 2%. They had a big deficit.

They were able to build the business from 0 in '81 to I think they were about 5 billion in 1989-1990, based again on this conceptual view of the capital markets, this need for diversification to small cap and then this potential premium always positioned as not as a guarantee, not that here's small cap stocks, you should go buy it, because you can get more return. It was a good diversifier and there's a premium there from the historical data, but there's also a big swing in that premium on a shorter term basis.

[0:20:41.6] CP: As our listeners know, Ben just did a paper on exactly this, pointing out that there's different factors and different timing of when those expected returns do show up. It was still institutional all through the '80s. Then Dan Wheeler came into the picture, who created the advisor side of the business.

How did that happen and what convinced David and Rex to consider that, because this wasn't in the wheelhouse before?

[0:21:05.6] DB: No. Not at all. Dan was a financial advisor in the mid-80s and he was working for one of the bigger wire houses at the time, and felt that he was not allowed to give his true, full independent advice to clients. I think, it was in – he used to tell a story about a client he had who was a woman that had a million dollar nest egg.

This woman was just a real basket case from – she was scared, she was nervous, she was she had been divorced and she had some alcohol problems. He used to tell the story that she was somebody who was very, very nervous about the capital markets and just the ups and downs and everything else.

He said that he felt that she needed to be in a fixed income portfolio, short-term fixed income portfolio, like a one-year treasury portfolio, just to have stability until she got out of this situation. He wasn't allowed to do that in his current employer. He felt there's a conflict there in terms of trying to be a fiduciary and act in the best interest of client, he wasn't allowed to do that.

He decided to go “independent.” Right about that time in the mid-1980s, Charles Schwab who's a big discount broker in the US opened up a platform that allowed independent advisors to basically custody assets at Charles Schwab. It also opened up what they call the first mutual fund platform. That allowed the advisor to select various funds off this platform and have it all on one statement.

An advisor could go and pick five different fund families and he wouldn't have to go to the fund family directly and have those statements come from those fund family. It could all be done through Charles Schwab.

It was this consolidation of the logistics and mechanics around advice that allowed independence, like Dan, to be an independent advisor and have one custodial platform that the client could put their assets on and then the funds could be select from that platform. That was what he did in 1985.

Come 1989, he was a big proponent of indexing, a big proponent of what John Bogle had done with the S&P 500. He was using the S&P 500 for his clients. He came across, in the newspaper came across the dimensional micro-cap fund and thought that was interesting. Again, loved to

give his his clients small-cap exposure alongside the S&P. He called up Rex Sinquefield and David Booth and said, “I'd love to access your funds.”

[0:23:38.4] CP: Amazing.

[0:23:39.1] DB: Yeah. They said, “We're not interested. We're an institutional money management. We only work with really big clients. We don't work with retail clients.” The reasoning for that was they've felt retail clients, the perception was that the money coming from retail clients would be hot, that if markets were good, money would come in real fast.

[0:23:56.9] CP: Which it typically is. That's how the industry typically works.

[0:23:59.0] DB: It still is. When markets were poor, people would get nervous and scared and they would pull money out. Dimensional’s fund, that micro-cap fund was very small cap-oriented, so it bought really small companies and fairly illiquid companies, and so they couldn't have this hot money come in and out of portfolio.

Dan said, “Well, nope. I've got a different approach. I'm an advisor. I work with my clients on a long-term basis. I have an investment policy statement. I talk to them in good markets and bad markets and we – me and my clients are going to look different than the average retail client investor. It's going to look much more like an institutional account, or client.”

Dan gave that story to them a couple times. They finally agreed. Dan became the first financial advisor working with Dimensional. He went about a year with that. Turned out the client flow was very, very stable, looked very much like the institutional assets. David and Rex thought that was a good start.

Dan came back and said there's another whole new set of advisors who were now independent that he'd like to make a business out of by going to them and having them access the Dimensional funds as well. That was the start of the financial advisor business at Dimensional.

[0:25:14.2] CP: Incredible. Then he joined Dimensional, started the advisor services side of the business. At what point did you come in?

[0:25:21.8] DB: I came in about four years later. I came in in 1995.

[0:25:24.4] CP: Asset levels would have been -

[0:25:26.7] DB: We were 9 billion as a firm.

[0:25:28.7] CP: Really?

[0:25:29.5] DB: Yeah. About a billion – a little bit of over a billion on the advisor side.

[0:25:34.3] CP: How did you find them? I know you talked about – we all have an aha moment, where this just makes sense. When was your aha moment and how did this all come together?

[0:25:42.6] DB: Well, like always in life, there's times there's random luck and there's times when you think you've been at the trough or at the bottom. As I talked about my injury, was pushed me into New York, so I thought, "Okay, this is where I want to be. I can be a finance major. I can apply everything I learned in school."

Basically, about three years into the job I just recognized that I wasn't really happy with what I was doing. I thought the delivery system that I had seen in New York was not the right one. I can get into that story in a moment if you like. It was very much high-commission, high-transaction, high-turnover and I didn't think it was the right solution for me as an investor, or for most clients when I watched how the mechanism was played out.

I was on the desk in New York and I happened to look at the USA Today and there was a small ad, two lines in the bottom of right-hand corner of the 17th page. It said, "Money manager, Santa Monica, California." I was a California kid. I liked those three words Santa Monica, California. I sent a resume in and it turned out it was Dimensional.

I got out there on a Christmas break in 1994 and went up to the office there at Santa Monica at 11th floor and got off the elevator and there was Dan Wheeler there to meet me. Then off to the left was David Booth and who is the founder and chairman, and then a guy named Merton Miller, who was one of the original board members, Nobel Prize winner.

[0:27:09.0] CP: Yeah, and pressing to say. No slouch on these ones.

[0:27:11.7] DB: No slouch at all. David walked up and said, “Hey, Dan.” He said, “I said I've got another meeting. Would you mind taking Merton to lunch with you?” Dan said, “Well sure, but I've got this new young kid potentially.” They said, “Oh, that's great and that's fine.” We went to lunch.

My first interview at Dimensional and I'm sitting there with Merton Miller, Nobel Prize winner. Merton, nicest guy in the world. Most modest, easy, funniest guy I've ever met. He was talking about all these simple capital market tenants, how markets work, diversification is your buddy, he used to call it, cost matter.

We had this really amazing lunch. Then we went upstairs to Dan's office and Dan sat me down and he basically said a line that I remember to this day. He said, “We are going to change the way investors experience investments in America.” I thought that was a pretty significant line. We're going to change the way the client experience happens.

I went back that night and pulled out my old corporate finance books and saw all the names that I had come across that day. This idea, I thought to myself, I could potentially be in finance and I could be doing something that I was really proud of. Up to that point, I was going to say in New York, I had decided I was going to get out of the industry completely and I was going to go be a high school basketball coach and teacher and I was just going to leave finance.

Again, one of those – is it luck? Is it how things roll through life as you look back? It was one of those moments, it was my aha moment where I sit there and listened to Dan. I thought, “This is very different from what I was experiencing in New York.”

What I was experiencing in New York just real briefly was I had a broker and that broker would call me on a daily basis basically and would pitch stock ideas to me. The idea was to get me to invest and to transact, because each time I transacted, he got a pretty healthy commission. When I was thinking about it, I thought that this guy knew nothing about my financial situation, he knew nothing about my family, he knew nothing about my net worth. All he wanted me to do was to trade stocks.

I had a moment in my last year there where this guy had called me and there's a company called Boston Chicken. Boston Chicken was a startup chicken company, or chicken restaurant in the States. He said, “Well, Boston Chicken was trading at 17. It was going to go to 24 and there's an earnings announcement next week, we think you got to buy it.”

Basically, I took half my net worth at the time, which was about $10,000 and I put it all into Boston Chicken, because I thought he'd mentioned that all-star analysts at this firm had said it was a great company and he pitched it. I did some of my own research and I thought, I’ll invest big in this.

Long story short, the following week came, the earning announcement came, I was on a business trip in Utah. I ran downstairs, I got a Wall Street Journal at the lobby, I opened up the paper to look for a Boston Chicken. Instead of saying 17 or 24, which I had hoped, it said 7. I had that moment of hope, I thought to myself, well there's a crease in the paper, so I thought maybe there's a one slid in between the crease. I pushed the crease out and it wasn't there. It was just seven.

I called him up and said, “What happened?” He said, “Well, it just didn't work out the way we expected it.” I thought to myself – that was his answer and I'm sure he had to make that answer to a bunch of other people he had promoted that particular stock to. I thought, “That's investment advice.” The way investment advice was built out at that time was just that, was to transact –

[0:30:48.8] CP: To distribute.

[0:30:50.3] DB: Distribute. This always having to say you're sorry to clients was the inevitable outcome. That was no way to really to do business, or do finance, or to do investment advice. That was an aha moment.

Fortunately right about that time, I had picked up the paper and literally, a month later I'd gone out to Dimensional, I heard this completely different story about the client experience and about being a fiduciary and act in the best interest of the client. I thought, “I could do this. I could do this for five or 10 years,” I thought to myself. Here we are 25 years later.

[0:31:23.7] CP: Can you talk about some of the basic principles that David and Rex instituted early on? Being selective on who they let in in terms of advisors, what principles that apply in portfolios, because you don't see Dimensional have any high-tech fund, or any flavor of the month type fund.

You're very deliberate in how you release products. There's been things that I see that have been very deliberate rules right from the get-go that don't seem to change, but I think made a huge difference.

[0:31:52.1] DB: Yeah, I think so on the “distribution side,” goes back to the story I told earlier, was David and Rex knew that there was institutional clients in the co-mingled fund, so the mutual fund portfolios. They needed to confirm that any assets that we're going to come in from the retail side, i.e. the advisors, was going to be compatible to the institutional assets in terms of being long-term buy and hold.

Part of our process at the front end and Dan's promise to David and Rex was look, we won't just waive in any money that comes our way. We will have these, called conversations and we'll have these conferences and educational interactions, where we have a good chance to get a feel for what the advisor does with their clients. The advisor, as independent advisors will have a good chance to kick the tires on us and have a longer moment of decision around whether they want to work with Dimensional and have Dimensional in their portfolios or not.

By doing that, by extending the – I'll call it the sales process, it allows both sides to make a decision as to whether you want to have a long-term relationship and whether it makes some sense to have that as part of the client portfolio.

One of the things we've always said from day one, Dan used to say is if there's something that makes more sense for your client, you should go use it.

[0:33:07.7] CP: He told us that in 2002, definitively. If you find a better solution, you must use it, because you are here representing your client, right?

[0:33:15.1] DB: You are in an independent advisor, you’re a fiduciary to client, you're acting in their best interest. We are one of 8,000 funds on that Charles Schwab mutual fund platform. Our

job is to basically get the advisor to understand why our portfolio is better for their client than the next one on the sheet. If that happens, then they're going to use us. If it doesn't, then they're going to use something else.

That's the one thing we've always been really clear at, has been really important is we've got this nature of independent advice is so different than what we would call vertical advice, where there's a big company and there's an employee who is actually a salesperson for that company and they're pushing product down to the –

[0:33:56.3] CP: They have budgets and sales targets. I know you do not have sales targets. I don't David even believes in that. I don't think you believe in targets. It will be what it will be. Just keep doing the right thing.

[0:34:05.8] DB: Right. The one beauty, we're a private company and David Booth runs it. It goes back to the pursuit of truth comment. These guys, all these Nobel prize winner, they really are academics at heart. They want to find the right answer.

We talked about what would we do with our own money? How would we invest it? It goes back to your point about did we jump at a tech fund because tech was hot? No. Because it didn't make conceptual, or academic sense to have a tech fund. It was a sector fund. It didn't make any sense.

[0:34:36.1] CP: You could've gathered assets.

[0:34:37.0] DB: We could have gathered assets, but these guys have consistently been very robust and I would say, sensible about how they view the capital markets and the research. There's a really high litmus test.

The thing I'm really proud of at Dimensional is that when we do our work and our research and think about portfolio construction and portfolio design and implementation, we have hundreds of people working on every detail of that portfolio, again from research to portfolio design, to portfolio management, to trading.

In each sense, we're trying to squeeze out that extra basis point, because the idea is that those basis points over five and 10 and 15 and 20 years, it might not seem like much. Who cares, right? 10 basis points, or five basis points. But five basis points over 20 years on a million dollar portfolio becomes a significant amount of money.

We're acutely aware of that and e build our business around the idea again, of trying to get to the most efficient answer for the client. That's been I would say one of the most things that I'm most proud of in terms of being affiliated with the company is just that.

[0:35:39.2] CP: The client being our clients. I think, I'd tell our clients that you don't work for us. I view you as working for our end-client.

[0:35:48.1] DB: Absolutely.

[0:35:48.9] CP: We are beside you working for the client.

[0:35:51.1] DB: It goes back to the early days in Dan's view on the great investor experience, investor, being your client. That investor experience happens when there's great expertise at the capital market level, which is what Dimensional does. We provide the expertise in capital market level.

Then at the client level, the advisors providing the expertise, we know nothing about the client and we know nothing about how you would allocate for your client. We know nothing about their risk profile. We know nothing about their family. We know nothing about their charitable aspirations.

What we do know is we do know how to build very, very efficient portfolios that are in essence building blocks that you as an independent advisor can take and build out the right solution for the client. Again, we think that combination of those two pieces delivers the great client experience.

That was what the essence of our purpose and our mission was from day one is how do we give a better client experience than what we see out there? Dan didn't see it where he was. I didn't see it where I was. Brad Steinman, who runs the Canadian business –

[0:36:53.2] CP: He was a guest on our podcast a couple months ago.

[0:36:54.6] DB: Same thing. The nice thing is we've had this – this community has been built. A lot of people who have been in the business for a long time, they've seen the negatives of the financial services business and they wanted to change it.

Again, when you have that purpose and that energy, then it turns into a real mission and that's what I think what's made Dimensional successful over the last 20, 25 years in the advisor space.

[0:37:18.8] CP: How do you react when – because I know we hear it. I'm sure you've heard it. "DFA is cult-like. They don't give us access to their funds." I know we have a lot of do-it-yourself listeners to this podcast. What do you think when that comes up?

[0:37:33.5] DB: Yeah. You hear that occasionally. I think it's one of those where we again, we're committed to this model. We think the advisor role is supremely important in delivering the investor experience. Our view is that we can put out great portfolios. If they aren't used properly, it can be a very, very bad investor experience or outcome. We have a fund that's called the Japanese Small Cap Fund.

The Japanese small cap fund has been the highest ranked mutual fund in the world at periods of time. It's been the probably the lowest ranked mutual fund in the world. If we were to allow the fund to just be out there, many would say, “Ah, it's the best performing fund in the world. I'll put my money on that." Then if it wasn't the best performing the following year, "I'm going to take my money back out.”

It goes back to my point around there's an obligation that we have from an investment, from a shareholder perspective. We need to protect shareholders in the funds. We can't have hot money coming in and out. That's detrimental to the funds.

On the institutional side, we have a process in terms of how we work with very big clients and governments and so forth. On the advisor side, we have a process which is a methodical

process and people have complained about how long it takes for us to go through our methodical process.

[0:38:47.6] CP: It's not easy to get access to the advisor with you.

[0:38:51.1] DB: It’s not easy, but it's about advocacy. We don't want to have and I think of outside the financial space just – you think about sales, there are people that pressure people into buying something. Oftentimes, the next day people wake up and go, “Oh, God. Why did I buy that?” We're not in that business.

What we try to do is we say, “Listen, here's our story. We're going to lay it on the table for you. We want you to go off and we want you to navigate through that story.” If there's a moment where it resonates in a moment where you say, “Ah, that would be good for my clients and that would be good for my business, etc.” Then we want to come back and we want to have a conversation. That's the process. That's the process that's worked for many years. We have very consistent cash flow as you know.

[0:39:33.2] CP: Which is a big deal for end-clients. Easy to rebalance.

[0:39:36.5] DB: Easy rebalance. We have very consistent relationships with advisors. I think that's built on the fact that we lay our story on the table, we set expectations, we tell you, Cameron, how we are going to build the portfolios, what you should expect.

We've never promised small-cap out performance. We've said, here's a small cap premium based on the data. There's again, volatility around that small cap premium that you should expect. Then you should be able to articulate that to your client and they should be ready for that potential outcome. That's all we've ever done.

Our view is if you do things methodically and slow, get people very comfortable with what you do and then you allow the process to happen in a consistent way, people are not going to be surprised with an outcome. They're going to see that expectation that was set - met on a regular basis. I think that goes into the whole concept of trust.

I mean, we talk about trust quite often. Bob Merton is another Nobel Prize winner, talks about trust. What trust is his competence plus trustworthiness. Competence being if you look at Dimensional's board and Nobel Prize winners and portfolio managers and infrastructure, there's competence there, a lot of experience, a lot of work that's gone into the result of the fund.

The other part is trustworthiness, which is a habitual meeting of expectation. If I interact with you and each time you walk away from my interaction, that you walk away and say, "That met my expectations, or that actually exceeded my expectation. That was great." If that happens over and over and over again, trust develops.

The way I describe is like your kid. You have your kid when they want to go drive, they go get their license and they go through the process. They pick up competence from their driving school. Then at some point in line, you got to hand the keys to your kid and they go off. They go off and drive.

Over time if they keep coming back with turning the right way and turning on the light, you're going to develop more trust over time, because of that trustworthiness that's repeated over time. Anyway, that's where we are. We're really about trying to develop trust with the advisor and the advisor's trust with the client.

[0:41:44.5] CP: I love your thoughts on the one decision portfolios that you brought to Canada 10 years or so ago. We used to use individual funds and do our asset allocation, rebalancing ourselves. It became obvious that we can't rebalance like you guys can quite frankly, right?

When you have positive cash flows coming in, you're able to rebalance with new cash flow, which is very tax efficient. It makes so much sense, but it's different to a client, because a client then sees one line item on their statement. We've had no problems with that. I truly believe to my core this is the best way to do things.

We've had great success using the one-decision portfolios for clients. Can you talk about what you see clients percepts when the value proposition is shifting, as you look at the overall financial advisor landscape around the world?

[0:42:29.9] DB: Yeah. I think there's more and more focus on again, on holistic wealth management. As I talked to advisors, there's certainly an investment aspect to the business and you still have to allocate, you still have to understand risk profiles, you still have to do all the things that think about taxes and so forth and so on.

Where you've commented on the one portfolio idea, there's an efficiency there in that. The simplistic view is if you have two boxes and you've got to take something out of one box and put it in the other one, there's going to be some cost there to take one and move to the other.

If you have one box and all those same components are in there and you can slide it back and forth without tax costs, without transaction cost, that's going to be more efficient. The idea and this is 15 years ago was these core portfolios were able to do just that. We're able to be more efficient in delivery of the capital market solution there to clients. That's been important.

I think the wealth management aspect, I think you're just getting more – there's more depth in the relationships with clients. I think the advisors are knowing more about the client's situation and what they are hope – what their hopes and dreams are, what the retirement will look like. I think there's a bigger emphasis now on that. How do you develop some areas of expertise that is going to be helpful to the overall client situation.

Yeah, I have an advisor and my advisor and I spend a lot of time on those types of concepts. What do I want to do in my charitable giving? How do I want to think about my kids' 529s, or college education funds? There's a lot of those kinds of conversations that happen in addition to the old investment conversation, which is what we've always historically have had. That's where they – I think the role is moving in.

The last part of that again is - I'll come back to this comment about trust. My advisor, my wife doesn't have any interest in finances at all. My kids, I got four kids under 16. Part of the reason why I have an advisor is that I know there's one phone number that if something, God forbid ever happen to me, I'd be able to hand that number to my wife and she knows my advisor well and he would take care of the family.

Just that in itself, people would say, "Well, that's different from an investment advice as it historically has been known," but that's a big component of what I would consider to be the

relationship. The relationship on the advice side I think has expanded to a very high degree from where it was maybe when I started 25 years ago.

[0:45:07.4] CP: Your co-CEO with Gerard O'Reilly, you guys clearly get along very well. You've worked together for I think 15 years or so. He's a great individual also. You talk about how you manage this together and where you see the firm going from here.

[0:45:22.4] DB: Yeah. I think the relationship has been great and we've known each other for 15 years. We didn't really work as closely obviously as we do now. He was a research person, a PhD from Caltech, rocket scientist, and I'm a guy from –

[0:45:35.1] CP: Literally.

[0:45:35.8] DB: Yeah, literally. Super, super smart guy. What I think people always ask me how does co-CEO work and are you able to be effective as a co? I think it comes down to the people. I could imagine if two firms got merged together and two CEOs came together and they now became co-CEO, that that would be a problem in terms of the alpha orientation, who's the dominant one and who gets controlled and that thing.

The one thing I will say and I appreciate about Gerard and I think where our relationship has really thrived is he's a super smart guy, but he doesn't claim to have every answer immediately. He uses a term and this is a I think a research term, he uses the term prior. My prior is this, which basically says, “I believe something. Here's what I see and here's what I think, but I'm willing to listen to what you have to say.”

As the married guy and it's like with your spouse, it's just you have to – you have to have that openness to conversation, to collaboration and so forth. Otherwise, you're going to get stuck in your holes and you're going to pound heads with one another. I look at that as really the – I think the essence of the relationship is a mutual respect.

He knows I've got a lot of experience with advisors over the years. I know he's got a lot of experience on the research side. We spend a lot of time thinking about how do we make that the best collaborative environment possible. It takes communication.

From day one, I walked in and I told him, I said, “Look, we can either do this together, or we can do this separately. If we do it together, it's going to be really fun. If we do it separately, it's not. I think we have to share everything. We have to be completely transparent, completely candid, we can't have any secrets or politics or anything like that.” He was in complete agreement. It's worked out just like that. We laid some good ground rules early. It's progressed in the way that I think we both had hoped.

[0:47:29.6] CP: Well, this goes back to the models that the economists used like Fama and French. They just build models of explanation to reality, but not necessarily reality. You guys are always open to change and that goes right back to your roots of working with Fama and French and all the different academics that are here.

What is it like working with those kinds of people? You work with them regularly on board meetings and whatnot.

[0:47:50.8] DB: Yeah, it's incredible. They are the most inquisitive - they're obviously all smart, but they're very modest and they're funny. I think that the modesty part is the part that strikes me the most, I think about working with this group. I think it started with Merton Miller, because people always talk about Merton as being the godfather of all these economists.

The way Merton collaborated and the way he had this level of modesty that was unparalleled, I think he set a tone for these guys that there always is another answer around the corner and you've never finished – finishing what you think you have. You never have the complete answer in a model. It's just that, right? Model is not reality. If it was reality, it wouldn't be a model. That's what Fama and French and these guys will always say.

What you always try to do is you try to look at what you – the empirical data that's out there, you try to build models that explain that empirical data to the best way possible and you continue to tweak that model to do better and to do more. The term that I heard Fama use one time is called the pursuit of truth.

You're never going to get to truth, but you're always in pursuit. I would say at Dimensional, that's really the culture of the business is this constant pursuit. It's a constant pursuit in trading. How

do we trade a little bit better? Can we do this? Can we tweak that to get another basis points? In research, can we use this information to translate into portfolio advancements?

All that's done with a very wary eye. I think that's where I – if I was a client of yours and of any advisor we work with, one of the things that I would take satisfaction is that you don't have this firm that's leveraging models and shooting for the moon and hoping for the best. It's a very sensible, methodical approach to capital markets and what we deliver.

Again, going back to the 38 years in the firm, the delivery has been just that; very consistent, very methodical, very clearly thought-out advancements in the capital market space. Dimensional frankly is number one. I mean, Dimensional is the firm that you asked a question earlier on when we talked about multi-factor and smart beta and all this stuff is starting to bubble up in the market, Dimensional has been doing that for 38 years. They were the first ones.

[0:50:04.2] CP: First ones.

[0:50:05.6] DB: By a longshot. It's interesting to watch the market. The markets transitioned from what I – where I started, which was high-transaction, high-cost, pick stocks, time markets, hope for the best. Look in the crystal ball and find something that's going to be an answer that's going to make me better off. To this new model, which is built around low-cost, diversification, multi-factor investing, coupled with independent advice, which puts the client in a much, much better situation.

That was what I think Dimensional modeled 30 years ago on the investment side and 25 years ago on the advice side. What we see now is we see this massive shift I think in the industry overall, moving in that direction, which if you say what's your greatest satisfaction? It would be just that. I think the clients are much better off today than they were 25 years ago when I started. I was paying 5% transaction cost on each stock trade.

When you think about what advisors charge and transaction costs has come way down.

[0:51:06.0] CP: Come a long way.

[0:51:06.8] DB: Then there's an independence factor, which makes it completely different experience for the clients. It's a much more fiduciary-oriented interaction. Things are positive. I don't see that it's slowing down. I think the energy is the right direction.

Again, that's why we all got together; Brad and Dan and myself. We didn't have any hopes of some size of a firm. We just said, "If we want change, we want to make it a little bit better." I think along with all the advisors we work with, I think we've done that to some degree.

[0:51:34.4] CP: My last question, I know we're tight on time. How do you define success?

[0:51:38.0] DB: That is the million dollar question, right? Yeah, for me I think it's family. I think if I can – my wife and my kids are happy. Success has nothing to do with accomplishment, or dollars or anything like that. If they're happy and they're well-balanced and they feel good about who I am and what I've done with them and for them, then to me that's success.

I would say the same thing with people say, "Well, as CEO or did you do this, or did you get this award in basketball?" I was like, "None of that ever really mattered to me." It was really more about the process and the pursuit of doing something well."

The purpose part is the part that if I feel if you can hit whatever your purpose is and there's all kinds of purposes out there in life, if you can do that and you can do it in a consistent way and have people say, "That person made a good impact on that," that's total success.

[0:52:30.0] CP: Well, you've certainly found a great place to do that here at Dimensional. Over 15 years, you had a huge impact, you and the whole team, a huge impact on us as advisors, but also you on the lives of our clients. We appreciate that.

Dave, thanks for the time.

[0:52:42.2] DB: Thanks, Cameron. I appreciate it.

[END]