

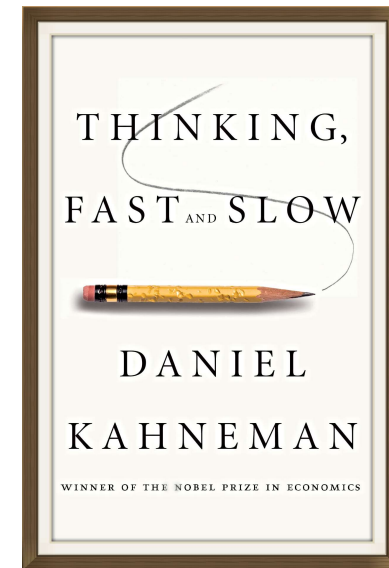
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SERVANT  
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**Investment  
Philosophy**

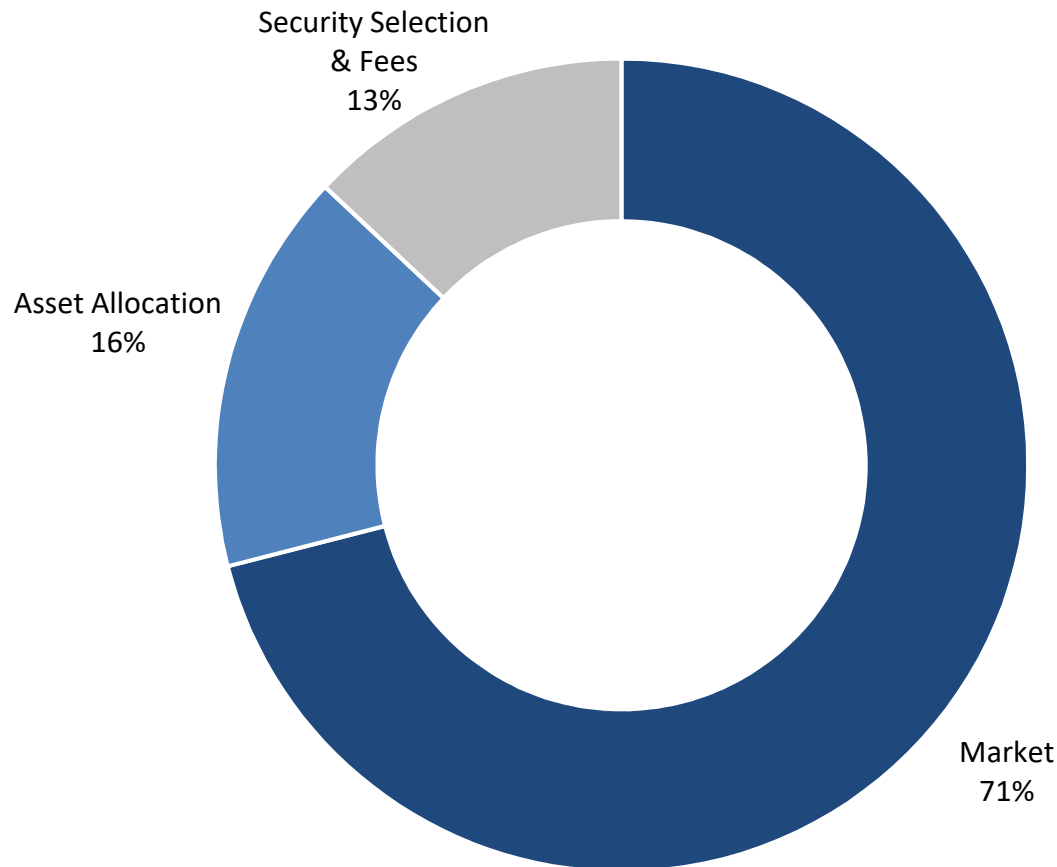
# Human Nature Is Not Built for Disciplined Investing

- How do many people invest?
  - Try to predict the future
  - Act on impulse
  - Listen to financial news media
- Human nature = cognitive biases
  - Confirmation bias
  - Anchoring
  - Loss aversion
- How to overcome?
  - Recognize biases
  - Develop an investment philosophy you can stick with

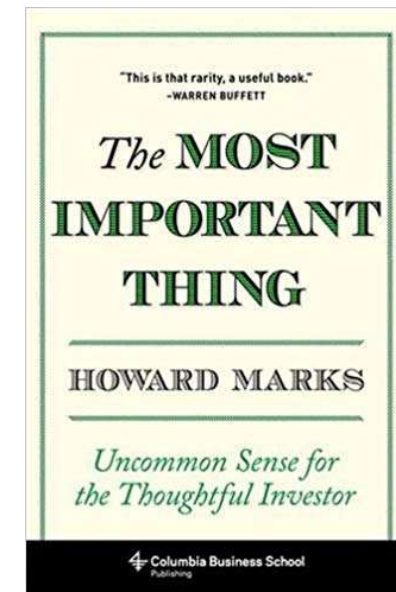


# Biggest Factor in Performance is Just Being Invested

## Drivers of Investment Performance

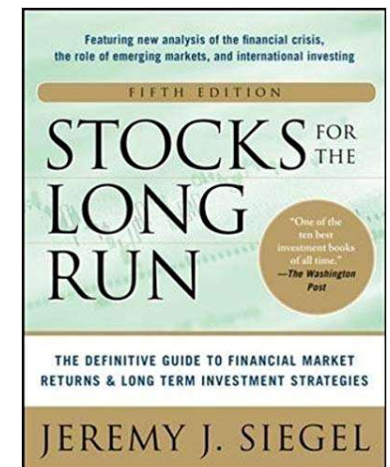
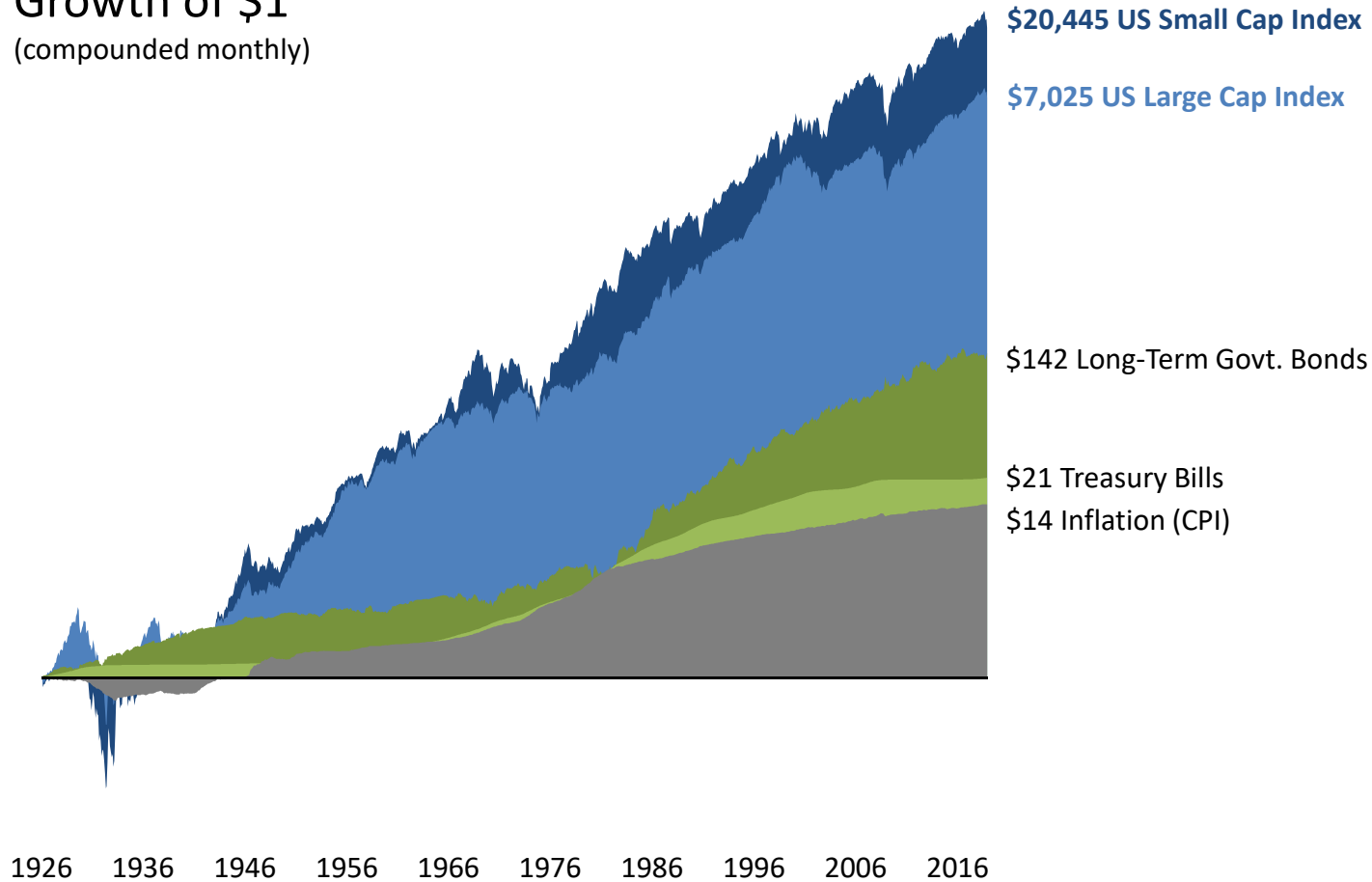


- Investing involves risk
- Not investing involves risk, too
- Market timing is difficult



# Markets Reward Equity Investors in the Long Run

Growth of \$1  
(compounded monthly)



# Three Ways to Invest

## Conventional

Active strategy

Stock picking

High fees and  
turnover

Demonstrated  
underperformance

## Indexing

Passive strategy

Earn the market  
return

Lowest fees

Vanguard

## Evidence-Based Approach

Quantitative  
strategy

Academic  
research

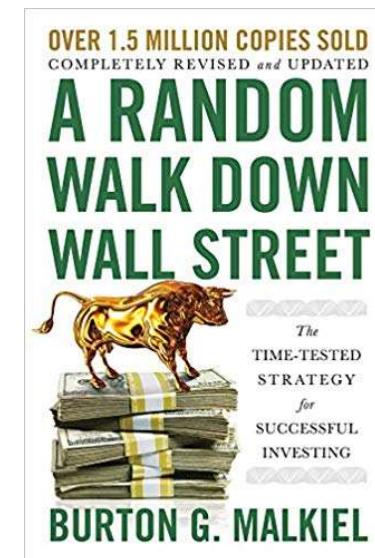
Maximize  
expected return

Dimensional Funds

# Benefits of Index Investing

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- Guaranteed to earn the market benchmark return
- Vanguard Funds – among lowest fees in the industry
- Can still build a customized portfolio focused on Asset Allocation



# Evidence-Based Approach

- Expected returns are driven by prices investors pay and cash flows they expect to receive
- Dimensions point to systematic differences in expected returns

## Equity Premium

Stocks vs. Bonds

## Size Premium

Small Cap vs. Large Cap

## Value Premium<sup>1</sup>

Value vs. Growth

## Profitability Premium<sup>2</sup>

High Profitability vs. Low Profitability

- To be considered a dimension of expected return, a premium must be:
  - Sensible
  - Persistent
  - Pervasive
  - Robust
  - Cost-effective

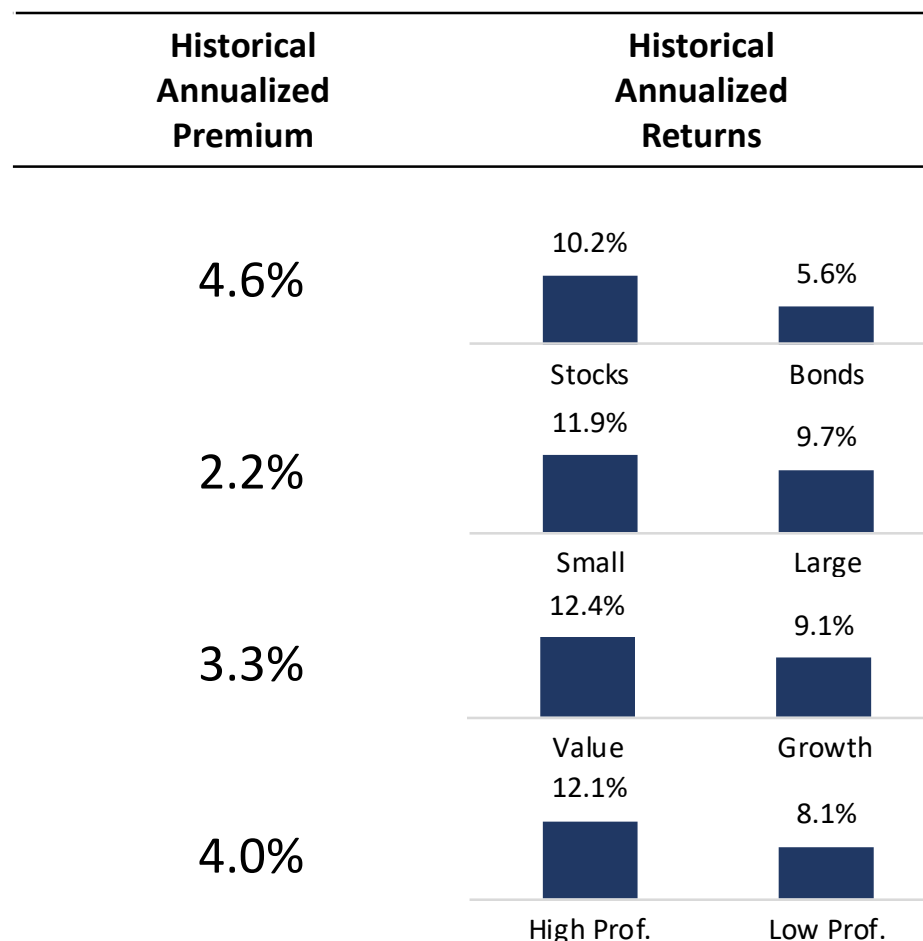
1. Value stocks are those with lower price-to-book ratios.

2. Profitability = operating income before depreciation and amortization, after interest expense, divided by book equity. Returns data from 1964-2018.

# Dimensions of Expected Return

## US Markets (1928-2018)

<b>Equity Premium</b> Stocks vs. Bonds
<b>Size Premium</b> Small Cap vs. Large Cap
<b>Value Premium<sup>1</sup></b> Value vs. Growth
<b>Profitability Premium<sup>2</sup></b> High Profitability vs. Low Profitability



1. Value stocks are those with lower price-to-book ratios.

2. Profitability = operating income before depreciation and amortization, after interest expense, divided by book equity. Returns data from 1964-2018.



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