



## **Nobel Prize for Eugene Fama: The genius whose thinking inspired The Red House investment approach**

You may have seen the news last week that Professor Eugene (Gene) Fama, known as 'The Father of Modern Finance' for his ground breaking work in establishing the Efficient Market Hypothesis in the 1960s, has been awarded the Nobel Prize in Economic Sciences.

### **Professor Fama's work**

The EMH holds that equity markets are an efficient pricing mechanism as all available information is contained in the price of quoted stocks. This discovery led to the development of index funds and showed that it is highly improbable that one can pick fund managers who will beat the market this year, let alone in five, ten, or 20 years' time.

The EMH alone was worth a Nobel Prize but Gene Fama continued with further seminal studies in the early 1990s with his co-author Ken French that produced the 3 factor model of equity returns. Quite simply this showed that an investor can achieve long term returns above the risk free rate (Treasury bills), by investing in:

1. The equity market.
2. Smaller company stocks.
3. Value (unloved) stocks.

### **Gene Fama, Dimensional and TRH**

We came across Gene Fama's thinking when we were setting up TRH in 2007. Disappointed by and no longer trusting the stories of traditional fund managers our research led us to Dimensional Fund Advisers (DFA). DFA was founded by David Booth, a student of Professor Fama's at the University of Chicago. DFA based its whole investment approach on Gene Fama's economic studies. (It is called 'Dimensional' after the three dimensions of equity returns identified in the 3 factor model). DFA's funds allowed us to create our own portfolios that capture whole equity market returns enhanced by tilts to small and value stocks.

Our partnership with DFA has also brought us a deeper understanding of investment theory and the ways we can help our clients earn the returns they deserve for taking equity risk. We met Gene Fama and Ken French when we visited DFA's HQ in Austin Texas in 2009. They both sit on the board of the company and still influence DFA's investment approach with the results of their continual research into market returns.

### **So, how does Gene Fama's work benefit you?**

The real genius of Gene Fama's work is that it allows us to ignore the noise and distractions emanating from the City imploring us to buy the most recent '10 Hottest funds' based on the latest 'financial news'. Instead, we can focus on what really matters; ensuring that our clients have the best opportunity of a successful long term investment experience so they have enough money to enable them to live the life they want to.



To see Gene Fama talk about his work click here -

<http://www.dfaeurope.com/2013/10/eugene-fama-awarded-nobel-prize-in-economics.html>

For clients who like 'getting under the bonnet' you can find out more on Gene Fama's genius by clicking on this link –

[http://faculty.chicagobooth.edu/john.cochrane/research/papers/Fama\\_nobel.pdf](http://faculty.chicagobooth.edu/john.cochrane/research/papers/Fama_nobel.pdf)

We hope you will all join us in congratulating Professor Gene Fama on his Nobel Prize.

**Ruth Sturkey and Gareth Marr**  
**The Red House**

**October 2013**

**Notes and risk warnings**

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