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The Investor Emotion Cycle: Quarterly Commentary

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Financial markets are now closing near all-time highs. It is only human to have emotional reactions to portfolio volatility, whether it be fear and anxiety to losses, or confidence and elation to gains. Being aware of the common emotions investors experience at certain phases will help you avoid them when you are comfortable with your portfolios plan.

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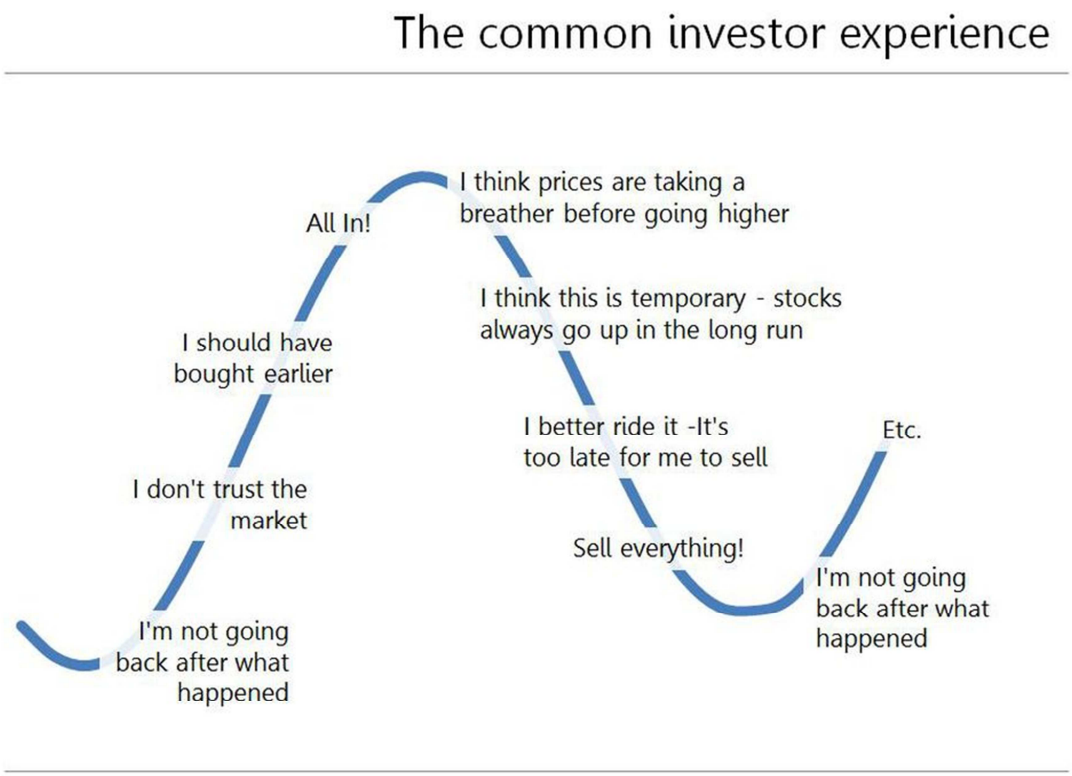


Everyone falls into a behavioral finance category according to the book "Behavioral Finance and Wealth Management" by Michael M. Pompian. It details the most common human investor types and associated personal finance-related biases....

1. The Preserver
2. The Follower
3. The Independent
4. The Accumulator

Can you identify your investor type?

The Preserver

A passive investor type, Preservers tend to value financial security and wealth preservation far more than growth. They are generally highly risk-averse, and losses are much more painful to bear than gains are a joy to experience.

Bias: Loss aversion. Preservers tend to experience a lesser degree of satisfaction toward gains and a greater degree of dissatisfaction toward losses, even if the amounts gained and lost are equivalent. Research shows that people will more often choose to sell their winners and hold their losers, hoping they can recoup the investment over time, even though this may lead to more losses.

Strategy: Slow and steady. Because volatility causes emotional anxiety, Preservers should not invest aggressively regardless of age and time horizon because they might be unable to stick to their investment plans during periods of market volatility, a tendency that often leads to long-term losses. Preservers should employ less risky, slower growing investments and other methods, such as higher savings, to achieve their long-term goals.

The Follower

A passive investor type, Followers tend to be compliant in taking the advice they receive even from friends, family and colleagues. They are often thoughtful and listen carefully to the advice of others but can be prone to making abrupt investment decisions at the urging of trusted friends or media commentators.

Bias: Regret. Followers fear regret and may undergo stressful emotional processes when threatened with the idea that they may make a wrong or unfavorable choice. People may fear shame or embarrassment and as a result make poor choices. After all, no one likes to be wrong. The result is that no choice is made and a desirable outcome may be missed.

Strategy: Stay the course. Followers should always consider whether or not advised changes are in line with their long-term goals and aspirations, and try to refrain from making snap decisions that dramatically shift the long-term expected risk and returns of their portfolios.

Independents and accumulators

The Independent

An active investor type, Independents can act quickly and decisively, and are usually confident in their own research. Though investors should always take the time to understand their investments, Independents study more than most. They are avid consumers of information and appreciate data over emotion when making decisions.

Bias: Conservatism. Like all active traders, Independents may become overconfident in their own research, and often make major decisions based on a positive or negative market outlook that can put their long-term goals in jeopardy. Independents may hesitate to take action based on new information in favor of initial data or impressions. This leads to inflexibility when it may be needed to attain the most favorable outcome.

Strategy: Match the market. Independents are generally analytical, and like to discuss their investments and holdings with their advisors. Work with a firm that values providing education and metrics to its clients and spend extra time discussing information in the context of specific personal biases to understand behaviors that might undermine sound decision making. Even with extensive data, the best strategy is to invest in the long-term growth of the market, avoiding the tendency to try time it, while remaining agile to reduce risk and capitalize on opportunities where possible.

The Accumulator

An active investor type, Accumulators are risk-takers and have a strong conviction in their ability to be successful investors. They often had great success in business, and

Bias: Overconfidence. The main mistake Accumulators make is that they often have a false sense of control, and are prone to taking excessive and unnecessary risks in their investments. Accumulators often struggle to adhere to a consistent strategy over the long-term, and may make dramatic short-term allocation changes based on their own beliefs in market direction.
Accumulators can overestimate their own skills and abilities relative to others. As a result, they may believe they can effectively time the market even in spite of an overwhelming body of evidence that proves this is not possible. This results in excess trading costs and associated fees with lower performance over time.

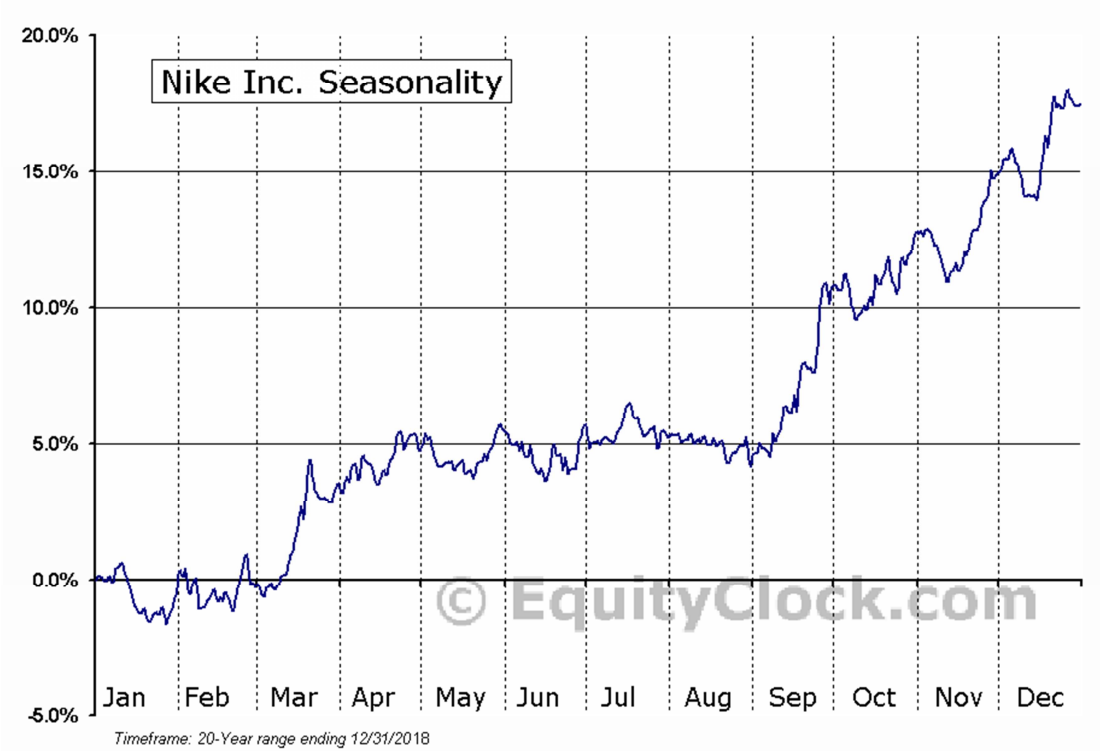
Strategy: Look for blind spots. Accumulators are generally highly confident in their own abilities and may self-select data to reinforce their individual schemes for how they view situations. Accumulators should seek out data that may be contrary to their preconceived beliefs in order to ensure they are achieving a balanced analysis before making important investment decisions.

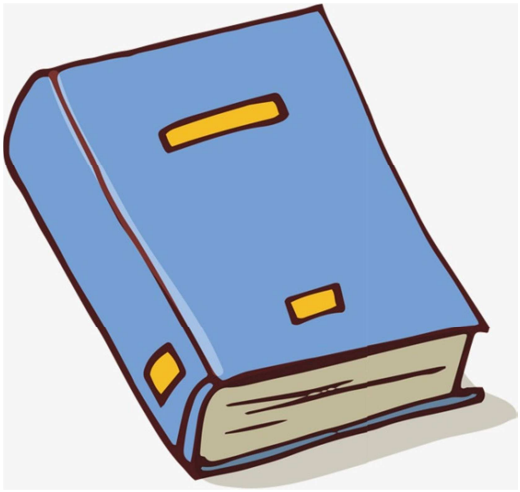
Seasonal Investment Opportunity

Seasonal investing refers to particular time frames when stocks/sectors/indices are subjected to and influenced by recurring tendencies that produce patterns. Tendencies can range from weather events (temperature in winter vs. summer, probability of inclement conditions, etc.) to calendar events (quarterly reporting expectations, announcements, etc.). The key is that the tendency is recurring and provides a sustainable probability of performing in a manner consistent to previous results.

Nike Inc.

Analysis of Nike seasonal charts show that a Buy date of August 31st and a Sell Date of December 26th has resulted in a geometric average return of 9.77% above the benchmark rate of the S&P 500 Total Return Index over the past 20 years. This seasonal time frame has shown position results compared to the benchmark in 18 of those periods. I use these dates as a guideline for when to enter and exit. Remember, seasonal investing is only a guide and not a guarantee.





Yield

The amount of cash (in percentage terms) that returns to the owner of the investment in the form of interest or dividends. For example, you might hear the 'yield is 5%'. This would mean you would recieve $500 for every $10,000 of your investment monthly, quarterly or annually depending how it pays.

Bull markets are born on pessimism, grown on skepticism, mature on optimism and die on euphoria. The time of maximum pessimism is the best time to buy, and the time of maximum optimism is the best time to sell.

— John Templeton —

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