

Perspectives

FOURTH QUARTER 2014

Stay or Leave? Deciding Whether It's Time to Go

By Ryan George
Director of Communications, 1st Global

While markets have tended to perform well over the long term, many stock and bond investors have underperformed. Why? The underperformance is often due to poor investor behavior, such as buying at market peaks and selling at market lows.

DALBAR, a leading financial services market research company, has analyzed when investors get in and out of the market over the past 20 years to see how their decisions compare to the wise investing adage to buy low and sell high. They found that the average mutual fund investor (calculated using a blend of both stock and bond mutual funds according to the DALBAR Quantitative Analysis of Investor Behavior survey) notched a 2.5 percent annualized return from 1994 to 2013, just a hair better than the inflation rate (2.4 percent) over the same time period.

This illustration from J.P. Morgan Asset Management shows how the average investor stacks up against asset classes

such as oil, stocks, gold, bonds and more. You can see that the average investor has underperformed other investment classes over the past 20 years, most of them significantly.

Poor investor performance can be traced back to the basic principles of behavioral finance. In order to correct the behavior, your financial advisor can help you identify if you suffer from one or even many of the following:

- **Loss aversion:** Expecting high returns with low risk
- **Narrow framing:** Making decisions without considering all implications
- **Anchoring:** Relating to familiar experiences, even when inappropriate
- **Mental Accounting:** Taking undue risk in one area and avoiding rational risk in others

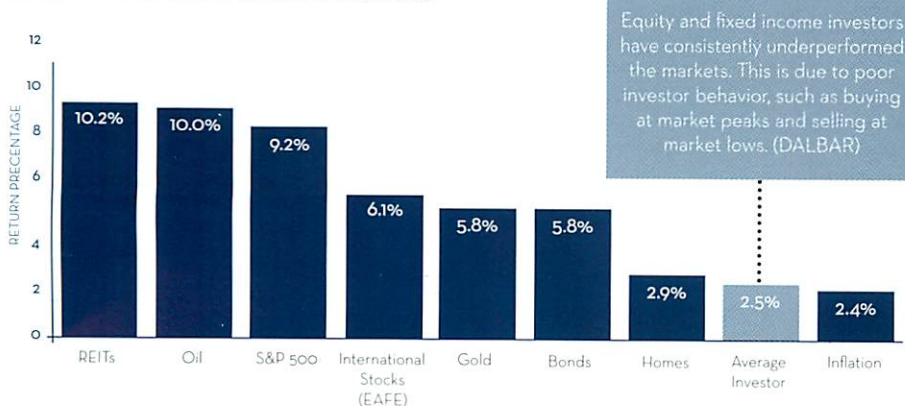
- **Diversification:** Seeking to reduce risk by simply using different sources, given no thought to how such sources interact
- **Herding:** Copying the behavior of others even in the face of unfavorable outcomes
- **Regret:** Treating errors of commission more seriously than errors of omission
- **Media Response:** Reacting to news without reasonable examination
- **Optimism:** Believing that good things happen to "me" and bad things happen to "others"

The bottom line is that long-term investment success requires patience and the fortitude to stay invested during good times and bad. It's easy to be right when the market is steadily rising, but during turbulent times, investors need guidance. Your trusted advisor exists to assist you and your family in creating an investment plan that is built upon sound financial planning concepts, not trying to time the market.

If you believe your investment decisions may be affected by the behavioral financial principles discussed in this article, it's time to sit down with your trusted advisor. Contact them today to set up a meeting.

THE BEHAVIORAL EFFECT ON INVESTOR RETURNS

20-YEAR ANNUALIZED RETURNS (1994-2013)



Source: 1st Global Research, DALBAR QAIIB 2014

Chart Disclosure: Past performance is no guarantee of future results. The indexes used are as follows: REITs: FTSE NAREIT Equity REIT Index TR USD, EAFE: MSCI EAFE GR USD, Oil: WTI Index, Bonds: Barclays U.S. Aggregate Index, Homes: National Association of Realtors median sale price of existing single-family homes, Gold: London Fix Gold PM PR USD, Inflation: CPI. Average asset allocation investor return is based on an analysis by Dalbar, Inc., which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior. Returns are annualized (and total return where applicable) and represent the 20-year period ending 12/31/13 to match Dalbar's most recent analysis. The above-listed indexes are unmanaged indexes. An investment cannot be made directly in an index. There are special risks of investing in REIT's such as lack of liquidity and potential adverse and economic regulatory changes. Commodities can be extremely volatile investments. International investing presents certain risks not associated with investing solely in the United States. This chart is for illustrative purposes only and is not intended to predict or depict the return of any one investment.

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Sources: J.P. Morgan "Guide to the Markets - 2Q 2014" www.jpmorganfunds.com, "Quantitative Analysis of Investor Behavior, 2014" DALBAR, Inc. www.dalbar.com.

Additional comment on the performance of REIT's and Gold- Remember that any discussion of the past returns of equity REIT's should always be accompanied by mentioning the often extreme volatility and cyclical nature of REIT's. There are special risks of investing in REIT's such as lack of liquidity and potential adverse and economic regulatory changes. In addition, investors should be aware that there is no assurance that gold will maintain its long-term value in terms of purchasing power in the future. Precious metals, like all investments, carry capital risk and can be highly volatile. Precious metals may appreciate, depreciate, or stay the same depending on a variety of factors.

Marriage, Money & Making Decisions

By Katie Howe

Marketing and Communications, 1st Global

With money arguments continuing to top the list of predictors for divorce, couples are finding it harder to agree on financial decisions and issues, often blaming three or more arguments per month on making financial decisions. While spousal financial decisions can be inherently stressful, how the decisions are made can make a difference. A recent UBS Investor Watch report broke down how couples make financial decisions into four categories: Shared decisions; separate decisions; man-led and woman-led. The researchers then weighed the pros and cons of each decision-making style to reveal which one is healthiest for couples.

Though man-led decision making is most common (40 percent), it may not be the best formula. While only 28 percent of couples shared the responsibility of making financial decisions such as investing, long-term planning, insurance and day-to-day expenses, the research from UBS shows these couples are happier and more at ease about their personal financial decisions and meeting their goals. In addition, these couples tend to be in agreement when it comes to real estate, large purchases, estate planning and college savings.

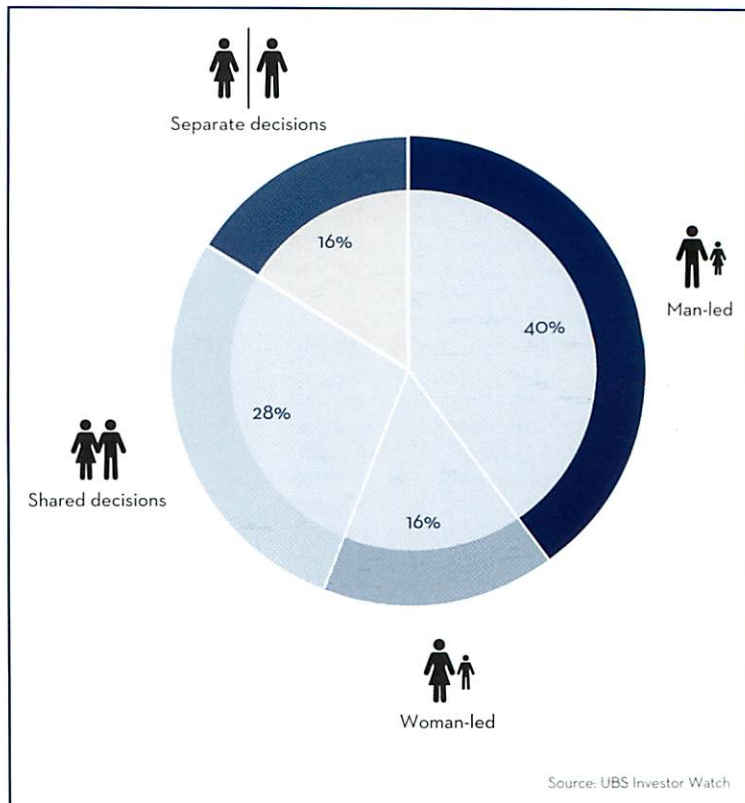
When the decision isn't shared, couples face difficulty based on their differing opinions about investing. Men typically have a higher risk tolerance than women. Men are also more focused on investing and beating the market, whereas women are more likely to focus on steady returns and saving. These conflicts contribute to the tension and difficulty making decisions for couples, leading many women to become more disconnected when it comes to investing.

In households led by men, women tend to have very little interaction with financial advisors as the men make most of the major financial decisions. Overall, women in these households are content with their lack of involvement in financial decision making — until it comes to retirement. At this point, they lack confidence and worry about their financial futures. Though woman-led decision making is one of the least popular categories of households, these women are naturally more confident about their future and retirement than women in other categories. They are also more likely to seek the advice of financial advisors to reassure them on the financial decisions they make.

Separation of Powers

When these decision-making strategies don't work, couples try to manage their differences by taking a separate decision making approach. These couples often create separate accounts in order to avoid compromise or choose a risk tolerance. They govern their finances with very little communication with each other or a financial advisor. Because decisions are left to the individual, the UBS study shows that these couples are more likely to use deception or hide assets on top of arguing about finances.

Couples approach financial decision-making in one of four ways



Need a Neutral Voice?

While every couple has the freedom to make financial decisions as they prefer, the research from UBS reveals that neither men nor women enjoy being the sole financial decision maker. Need a neutral negotiator to help reset your household finances? Contact your trusted financial advisor to help you and your spouse establish short- and long-term financial goals, and to help diffuse any issues that may arise.

¹Kansas State University research, <http://www.k-state.edu/media/newsreleases/jul13/predictingdivorce71113.html>

²UBS Investor Watch, "Couples and money: who decides?" 2Q 2014.



12750 Merit Drive | Suite 1200
Dallas, TX 75251 | 877-959-8400
www.1stGlobal.com