



Fiduciary Wealth Management LLC

Patrick D. Roth, Managing Partner

Christopher J. Broderick, President

4604-H Pinecrest Office Park Drive
Alexandria, Virginia 22312
(703) 242-1231/office
(703) 649-6161/fax
info@fidwealthman.com

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A couple of charts to serve as a reminder (to us all) on the potentially negative power of emotions and investor psychology in influencing investment decisions.

We are all aware of the “Buy Low, Sell High” mantra of investing. The difficulty in implementing this obviously desirable strategy is knowing when an investment opportunity is priced “High” or “Low”. In the absence of intellectual confidence about the situation we are apt to rely instead on emotions—Our Gut.

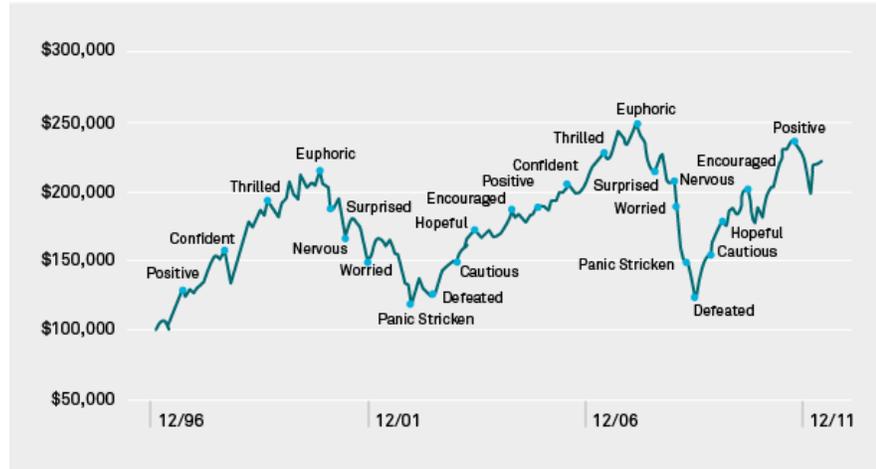
We have been reading about a phenomenon in the field of Behavioral Finance (this is a field of finance research that proposes psychology-based theories to explain investor behavior as opposed to more traditional “rational” investor theories) known as Availability Bias. This is the tendency to overweigh evidence that easily comes to mind. For example, if you were in a car wreck today it would be natural for you to drive more carefully for the next couple of weeks or months. The more recent and the more headline grabbing the event, the more readily it is recalled and influential it can be in driving decisions. Those big, bold headlines screaming “Dow Breaks Record!” or “Market Tanks!!” come to mind.

The top chart to the left does a good job of illustrating the emotional rollercoaster some investors experience at various stages in a market cycle. Distraught at the bottoms and joyous at the tops. Makes sense to a degree but clearly runs opposite of the buy low sell high school. If you are consistently investing throughout a market cycle (say through your 401K plan or other retirement savings plan) you would see the valleys as opportunities and the peaks as cautionary periods. Just the opposite of the emotional states described in the graph.

The real kicker is the bottom chart. Perhaps driven by the emotions already described, this chart illustrates that investors actually “Sell Low and Buy High”. When markets are at their lowest money floods out of mutual funds (meaning folks are selling) and when markets are at their highest we see large flows of money into mutual funds (folks are buying).

Do Your Emotions Lead You Astray?

Growth of a Hypothetical \$100,000 Investment in the S&P 500 Index Over 15 Years (1997-2011)

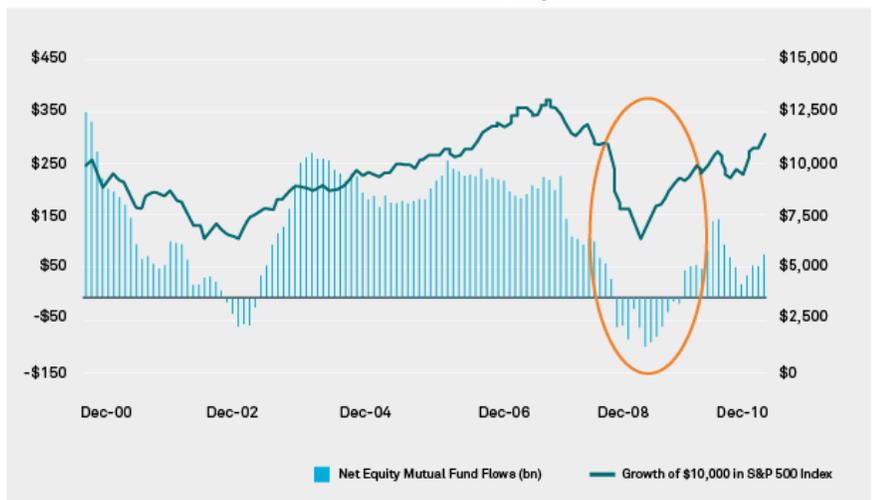


Sources: BlackRock; Informa Investment Solutions. Emotions are hypothetical and for illustrative purposes only. The S&P 500 Index is an unmanaged index that consists of the common stock of 500 large-capitalization companies, within various industrial sectors, most of which are listed on the New York Stock Exchange. Returns assume reinvestment of dividends. It is not possible to invest directly in an index. Past performance is no guarantee of future results. The information provided is for illustrative purposes only.

These two charts, and the interesting work being done throughout the Behavioral Finance field, are great reminders of the importance of a long-term perspective built around a sound and consistent investment strategy that allows us to be the *skeptical investor*, wary of the emotional highs and lows associated with investing and the tendency of our own biases (magnified by media overkill) to get in the way of good decision making.

Enjoy the beach, no matter what they tell you on Shark Week!

S&P 500 Index Performance vs. 12-month Equity Mutual Fund Flows



Sources: BlackRock; Informa Investment Solutions; DB US Equity Strategy; Investment Company Institute (US mutual funds and ETFs). The S&P 500 Index is an unmanaged index that consists of the common stock of 500 large-capitalization companies, within various industrial sectors, most of which are listed on the New York Stock Exchange. Returns assume reinvestment of dividends. It is not possible to invest directly in an index. Past performance is no guarantee of future results. The information provided is for illustrative purposes only and is not meant to represent the performance of any particular investment.

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