

Volume XXV, Issue I

THE HARBOR ADVISOR

Investor Psychology: Biases of Judgement

Last quarter I postulated on individual perspective and the importance of developing a sense of proportion and relativity as it pertains to investing and financial planning. Lack of a clear perspective can and does plague individual investors and dramatically affects the returns achieved from investments and the success of one's financial plan. This quarter I will explore some common pitfalls that befall the individual investor and what can be done to avoid the negative commonalities.

Individual investors have a poor track record when it comes to matching the various index returns. Rather than blame the choice of an active manager often the true cause is irrational decision making causing the investor to buy and sell at the wrong times. Specifically, investors have great tendency to sell when market prospects look bleak and then rebuy once they have recovered.

The psychology of this behavior has been studied and then grouped into several descriptive categories. We will call the group Biases of Judgment, the category has a number of commonalities:

Overconfidence - This bias leads to a lack of diversification since the investor thinks he or she can predict an individual category performance. It can also lead one to a more risky group of investments due to a lack of understanding of the risk involved. Trading too much is another outcome as the overconfident investor thinks they can time the market.

Optimism - Too much can lead to underestimating risk since the optimist underestimates the possibility of a bad outcome. It can also carry with it an illusion of control. Being more realistic can lessen the frequency of surprises and aid better investing decisions.

Hindsight - Individuals are prone to memory distortion or misremembering events and outcomes. We have all heard 'I knew this was going to happen' when of course we can't predict much in market behavior.

Knowledge of the markets, yourself and the economic realities in the world around you goes a long way towards creating a realistic perspective. Seeking and taking good advice helps as well. At Harbor we try to educate, focus on the individual and his or her needs. We apply a long term view to the management of assets and the positive outcomes for a life- long financial plan. Through the employment of these techniques we have enjoyed much success in personal investing. For more information on this topic be on the lookout for our white paper under resources on our website

Contents

Main Articles

| | |
|------------------------|---|
| Investor Psychology | 1 |
| How We Create Models | 2 |
| More Than Just Mint??? | 3 |
| Harbor Happenings | 4 |

Individual Highlights

| | |
|----------------------------|---|
| Investor Psychology | 1 |
| Q1 2015 Market Recap | 2 |
| Fund Focus | 2 |
| Art & Science of Investing | 3 |
| Living Well/Living Smart | 3 |
| Market Closures | 4 |

2015 Anniversaries

60 Years Ago – "The Lord of the Rings" was published and became one of the best-selling novels ever written and Disneyland opened in California.

April 12, 2015



Market Recap – 1st Quarter, 2015

Tumbling oil prices once again led the headlines during the first quarter. Low oil prices have had mixed global effects. Countries with economies reliant on oil exports, such as Russia and Venezuela, have been severely affected. In the U.S., consumers and many businesses have benefitted from cheaper oil. Yet, low oil prices have been detrimental for oil companies and regions that depend on oil production, such as North Dakota and Texas. Workers have begun to lose their jobs, real estate activity has slowed and spending on equipment related to oil production has been delayed or halted indefinitely.

Still, the U.S. economy continued to grow, bolstered by low inflation, earnings growth and improvements in the labor market. In Europe, The European Central Bank began quantitative easing measures with the goal of keeping the Euro weak and interest rates low to promote exports. In combination with lower energy prices Europe's economy showed signs of improvement during the quarter.

Both equity and bond markets posted gains during the quarter: The Barclays Aggregate Bond +1.61%, S&P 500 +0.44%, Russell 2000 + 3.99% and MSCI EAFE +4.19%.

"Much success can be attributed to inactivity. Most investors cannot resist the temptation to constantly buy and sell." Warren Buffet

Fund Focus: Vanguard Energy Fund

The most recent inclusion in our models is Vanguard Energy Fund (VDE), an exchange traded index fund which tracks the MSCI U.S. Investable Market Index (IMI)/Energy. Containing large, mid and small companies within the energy sector. VDE attempts to duplicate as closely as possible the index performance. This index is market cap weighted and broken into sub-industries. Its current weights are roughly 38% in Integrated Oil & Gas, 25% in Oil and Gas exploration, 16% in Oil & Gas equipment and services and 10% in Oil & Gas storage and transportation.

As we know, energy prices have been rapidly declining in recent months. This is due to many factors, mostly on the supply side of the chain. U.S. producers and new oil extraction technologies have led to increased production across North America. OPEC continued to produce oil at a quick rate. When demand fell slightly in the fall, there was a glut of supply on the market that drove down prices. Due to current production rates there is more supply than demand. Since much of this price slide has been due to purposeful manipulation of the supply, we believe energy prices will rebound to a more natural economic meeting point.

How We Create Models at Harbor

Harbor portfolios are carefully researched and monitored using a detailed and methodical process. This process allows for consistency and ensures that nothing is forgotten. We have found that a workable, successful portfolio model is a combination of research around the science of portfolio management and art. The latter is based on experience, knowledge of how markets work and understanding people and what will meet their needs.

1. **Answer the 'Who Are You?' questions:** What are you trying to accomplish? Do you need the investment funds near term or is it long term, way out into the future money? Do you need income from the portfolio? What amount of risk are you comfortable with? How do you feel about volatility?
2. **Which allocation between equities and fixed income is best for you?** The decision will vary by individual and depends on a number of factors including risk, experience, overall resources, time horizon, and other factors.
3. **Specific Investments:** Harbor models are prepopulated with a mix of varying capitalization of companies, domestic versus foreign and also different asset classes, for example Swiss Francs, gold, real estate, etc. We usually use a mix of index funds, individual stocks and actively managed funds.
4. **Implementing the Model Allocation:** This process requires thought and a plan as well. Portfolios come to us with existing positions which need to be researched as to cost basis and therefore capital gains tax at the time of sale. We tend to sell all positions carrying a loss as the loss can be used to offset taxes due in the year it is realized. We will try to avoid short term gains given the high cost for the tax. We develop a plan for all long term gain positions that we decide to sell and coordinate this with the client's accountant or with them if they prepare their own taxes. If a portfolio comes to us in cash we counsel that it is usually best to move into the market in segments, frequently using 1/3 of the cash at a time over a period of three months hoping to level out market pricing. Again this is discussed with the client to determine their wishes. If the portfolio is tax deferred (a retirement plan for example) we are free to implement without tax consequences.

Monitoring is also a methodical process at Harbor. We employ rebalancing software so we are able to frequently review target allocations and trade positions with gains when advisable. For more on this subject be on the lookout for a research paper on our website under Resources.

Mr. Spock and the Art and Science of Investing

Jim: You'd make a splendid computer, Mr. Spock. Spock: That is very kind of you, captain.

Earlier in this newsletter we spoke about biases of judgement that negatively influence the choices an individual makes in their portfolio. One writer has compared successfully managing a portfolio as a contest between Mr. Spock's, rational, unemotional decision making, and Captain Kirk who relies on hunches and instinct. While both points of view have virtue, Spock is the easy winner in the portfolio game. Unfortunately, when it comes to our money, most of us behave more like Captain Kirk and this allows for the biases of judgement and subjectivity to creep into our portfolio selections. Most investors underestimate the stress of managing a portfolio when the market is going down and are overconfident in their asset management skills when the markets are going up. Having a professional wealth manager handling your portfolio can diffuse the emotion and allow for taking a step back or at least making a phone call before hitting the 'buy' or 'sell' button.

While performance is one reason to choose a professional wealth manager, there is another that for many people is immeasurably more compelling. Researching, tracking and maintaining an investment portfolio takes an enormous amount of time, discipline, practice and perseverance and may just not be how you choose to spend your time. Ask yourself some questions, "Am I knowledgeable about investments? Do I enjoy reading about them and doing research?" Investing as a hobby is not for everyone and while the intention may be there, studies have shown that the actual time spent by investors each year on their company retirement plans, a large part of many people's net worth, is in fact paltry. Having a professional involved harnesses economies of scale in the time required to adequately supervise a portfolio and frees you to spend your precious time on other pursuits.

Investing can be a thorny subject and there are numerous issues to consider to both safeguard your assets and maximize them. Avoiding the biases and pitfalls and having the time to spend as you wish without feeling you are neglecting your finances are both valuable aims. And while "peace of mind" can feel like an overused phrase in the wealth management sphere, it is still a good description of what a client may expect. Or in the words of the inestimable Mr. Spock, "Live long and prosper."



More Than Just Mint???

As many of you know, Mint.com is a budgeting and spending tracking tool. For those of us new to the budget tracking apps, we ask: "Is Mint the only money management tool available?"

Here are three free apps that many financial professionals feel deserve to stand alongside Mint:

BillGuard has received accolades from CNNMoney for being the best app to manage your money. It protects against debit and credit card fraudulent charges and errors, allows the consumer to connect directly to merchants with the app to resolve billing issues, view charges flagged by others in the community, and follows your spending patterns in an effort to provide coupons that are useful to your unique spending habits.

Spending Tracker allows the user to set a fixed budget amount in order to meet set goals. Remaining funds can be carried over to the next period. The periods are also set by the user, which means that you may elect to use weeks, months or years as your timeframe. Spending Tracker provides you with the interactive charts that are grouped by category.

Checkbook The Checkbook app was designed to replace the traditional pen and paper version, while also including a way to track card and cash expenditures. It boasts quick search options, account to account transfer options, and reconciliation abilities.

We believe that managing your spending can have the greatest effect on the success of your financial plan. We suggest you give one, two or a few a try and see what suits your style the best.

Living Well/Living Smart

Colorado Museums You May Never Heard Of

We all know that there are many fantastic museums in Denver – art, history, nature and science. However, there are some small, unique museums that are a bit different and even a little weird. Have you visited any of these?

Lee Maxwell Washing Machine Museum Eaton, CO

Take a look at all the different machines while you browse through the museum with the Guinness World Record for the most antique washing machines. You'll find more than 1,400 different machines dating back to 1840.

Cripple Creek Jail Museum Cripple Creek, CO

Legends and lore of the old west make up some of the most interesting history. You can browse through the original cells as well as see exhibits about different criminals that have stayed here.

Money Museum Colorado Springs, CO

View age-old to modern-day coins and paper money and learn about the history of making money.

Denver Museum of Miniatures, Dolls & Toys Denver, CO

You will find houses, trains, cars, dolls and many other miniature collections here. They also have a tea room.

Colorado Gators Reptile Park Mosca, CO (I know... this isn't a museum, but it's weird)

The alligators flourish here because it sits atop geothermal wells. They claim to be the only "gator rescue" in the US. Some of the inhabitants weigh over 600 lbs.

Ghost Town Museum Colorado Springs, CO

A fun and historic look back at an old west town during the late 1800s. It includes a Blacksmith's Shop, Saloon, Livery Stable, General Store, gold planning and more.

Harbor Financial Group, Inc.

1909 26th Street, Suite 1A
Boulder, CO 80302

3773 Cherry Creek North Dr., Suite 575
Denver, CO 80209

P: 303.939.8788
F: 303.541.1059

info@harborfinancialgroup.com

Find us on the Web:

www.harborfinancialgroup.com



Images: Lars Sundström, Fleur Suijten

Harbor Happenings

Client Survey

Our clients will be receiving an online Harbor Financial Group survey soon. We ask that you please take a couple of minutes to answer the survey so that we can better serve you. A \$10 contribution will be made to the charity of your choosing for each response we receive.

Welcome Lake McGill

Please join us in welcoming Lake McGill to the Harbor Team. Lake will begin his new internship with Harbor this spring.

2015 Closures

Our office is closed on the following New York Stock Exchange holidays: May 25, Memorial Day; July 3, market holiday in observance of Independence Day; September 7, Labor Day; November 26, Thanksgiving Day; November 27, half day; December 24 half day, Christmas Eve; December 25, Christmas.

The majority of our growth over the past 27 years has come from referrals from clients and other professionals. We thank those of you who have referred your friends and colleagues. If you know of anyone who might be interested in our services, please ask them to give us a call at 303-939-8788.