



### Your Money and Your Brain

I've been reading the above captioned book, by Jason Zweig. I'm not quite all the way through, but I've read enough to recommend the book.

Zweig delves into the inner workings of the human brain as decisions about finances and money are processed. This is a fascinating subject. The book explores what Zweig calls neuroeconomics and sets forth some basic lessons:

- *a monetary loss or gain is not just financial or psychological in outcome, but a biological change that has profound physical effects on the brain and body;*

This means that, at the bottom of it all, reactions to financial outcomes are strongly hardwired. The implications of this finding on financial decision-making are addressed below.

- *the neural activity of someone whose investments are making money is indistinguishable from that of someone who is high on cocaine or morphine;*

Zweig reports on studies on the chemical dopamine in the brain, which is related to reward recognition. In comparing activity in the brains of cocaine addicts who are expecting to get a fix with people who are expecting to make a profitable financial gamble, the similarity is, in Zweig's words, chilling.

- *after two repetitions of a stimulus – like, say, a stock price that goes up one penny twice in a row, the human brain automatically, unconsciously, and uncontrollably expects a third repetition;*

So, now that the market has been going up for a while, our brain simply expects that it will continue to go up. Remember late 2008 and early 2009 when your brain was telling you that the market would continue to go down?

- *once people conclude that an investment's returns are "predictable," their brains respond with alarm if that apparent pattern is broken;*

Unexpected events in the financial markets are much harder to absorb and process than events that are more "predictable".

- *financial losses are processed in the same areas of the brain that respond to mortal danger;*

This lesson goes a long way in helping us understand why the emotions we all felt as the market dropped like a roller-coaster in the latter part of 2008 and early 2009 were so intense.

- *anticipating a gain, and actually receiving it, are expressed in entirely different ways in the brain, helping to explain why money does not buy happiness;*
- *expecting both good and bad events is often more intense than experiencing them.*

This can help explain why gambling addictions are so hard to break, and why it is so difficult to convince some folks why chasing hot stocks and hot mutual funds is a fool's errand.

The lessons also help us understand the intensity of the expectation that we can predict the direction of the market, and how the disappointment of unmet expectations is felt so intensely. Zweig explores our predilections to jump to conclusions based in little information, our inclination to see meaningful patterns in information that is truly random and our tendency to be overconfident of our ability to predict outcomes.

Reading this book reinforces my perception that a structured approach to investing, with sensible expectations and a clear perception of downside risk gives us the best prospects for long term investing success. I recommend it.

### Financial Regulation

We are hearing a good deal of noise now about financial regulation. Buried under the focus on increasing the regulation of banks and other financial institutions is an effort focused on regulation of financial advisors.

Late last year, seeing the prospect of regulation of financial advisors on the horizon, the Financial Planning Association, the National Association of Personal Financial Advisors, and the Certified

Financial Planner Board of Standards, all organizations to which I belong, joined forces as the Financial Planning Coalition to try to influence the direction of regulatory reform toward better treatment of consumers of financial advisory services through a broader application of the fiduciary standard of care for all advisors. The Coalition has advocated for a fiduciary standard for all who hold themselves out as financial planners. The consensus at the Coalition is that this "raising of the bar" will benefit consumers and leave them less open to some of the worst practices seen in the financial services industry. I would like to hope that this would be the case, but I am also aware

that the law of unintended consequences always remains in the background of regulatory efforts. It appears that the regulatory scheme may turn out to be the broad imposition requirements of certain minimum competency and ethical standards for anyone who markets themselves as a financial planner. The current bill commissions a study of these requirements.

I'll keep you advised on these developments.

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### Market Review

The table below shows the returns through March 31<sup>st</sup>, 2010 for selected basic investment asset classes. In most cases, the results below are appropriate benchmarks for the related mutual funds in your investment portfolio. We are delighted to note the wonderful performance of the market over the last 12 months. Remember to not get carried away; this too shall pass.

Asset Class Performance

| Asset Class                     | Index or Proxy <sup>1</sup> | Last 3 Months | Last 12 Months | Peer Group Mstar Category or Average <sup>2</sup> | Last 3 Months | Last 12 Months |
|---------------------------------|-----------------------------|---------------|----------------|---|---------------|----------------|
| US Core Equity 1 & 2            | Russell 3000                | 5.95          | 52.44          | US Core Blend                                     | 6.10          | 54.21          |
| US Vector Equity                | Russell 2500                | 9.21          | 65.71          | US Vector Blend                                   | 7.51          | 59.71          |
| Int'l Core/Vector Equity        | MSCI World Ex U.S.          | 1.35          | 55.96          | Int'l Core & Vector Blend                         | 2.73          | 59.28          |
| Ultrashort Bonds – Corp.        | 3-month Treasury Bill       | .03           | .13            | Cat: Ultrashort Bond                              | .89           | 6.73           |
| Short Term Bonds - Municipal    | Barcap 2-4 Yr Municipal     | .30           | 3.68           | Cat: Muni National Short                          | .44           | 4.25           |
| Short Term Bonds – Gov't.       | Barcap 1-5 Yr Government    | .93           | 1.67           | Cat: Short Government                             | .92           | 3.24           |
| Short Term Bonds – Corp.        | Barcap 1-5 Yr Govt/Credit   | 1.20          | 5.31           | Cat: Short-Term Bond                              | 1.42          | 9.75           |
| Intermediate Term Muni. Bonds   | Barcap 10-Yr Municipal      | 1.40          | 7.72           | Cat: Muni National Interm                         | .97           | 8.85           |
| Intermediate Term Bonds – Gov't | Barcap IT Govt              | 1.12          | .87            | Cat: Interm. Government                           | 1.59          | 4.81           |
| Intermediate Term Bonds – Corp. | Barcap IT Credit            | 2.36          | 18.72          | Cat: Interm-Term Bond                             | 2.44          | 16.76          |
| Global Bonds                    | Citigroup World Govt        | -1.33         | 6.31           | Cat: World Bond                                   | 1.14          | 17.63          |
| Domestic Large Cap Core         | S&P 500 TR                  | 5.39          | 49.77          | Cat: Large Blend                                  | 5.07          | 50.08          |
| Domestic Large Cap Growth       | S&P 500/Citigroup Growth    | 3.71          | 45.44          | Cat: Large Growth                                 | 4.41          | 48.34          |
| Domestic Large Cap Value        | S&P 500/Citigroup Value     | 7.09          | 54.68          | Cat: Large Value                                  | 5.61          | 50.26          |
| Domestic Small Cap Core         | S&P 600 TR                  | 8.61          | 64.00          | Cat: Small Blend                                  | 8.18          | 65.43          |
| Domestic Small Cap Growth       | Russell 2000                | 8.85          | 62.77          | Cat: Small Growth                                 | 7.36          | 58.97          |
|                                 | S&P 600/Citigroup Growth    | 7.30          | 61.74          |   |               |                |
| Domestic Small Cap Value        | S&P 600/Citigroup Value     | 9.94          | 62.28          | Cat: Small Value                                  | 9.40          | 70.34          |
| Real Estate Investment Trusts   | FTSE NAREIT-Equity          | 10.02         | 106.68         | Cat: Specialty Real Estate                        | 9.33          | 104.91         |
| Int'l Large Cap Core            | MSCI EAFE                   | .87           | 54.44          | Cat: Foreign Large Blend                          | 1.28          | 53.26          |
| Int'l Large Cap Value           | MSCI World ex U.S.          | 1.35          | 55.96          | Cat: Foreign Large Value                          | 1.09          | 52.99          |
|                                 | MSCI EAFE Value             | -.24          | 58.52          |   |               |                |
| Int'l Small Cap Core            | MSCI EAFE Small Cap         | 4.77          | 70.02          | Avg: Foreign Small Blend                          | 4.41          | 78.19          |
| Int'l Small Cap Value           | DFA Int'l Small Cap Value   | 5.04          | 68.78          | Avg: Foreign Small Value                          | 5.29          | 82.99          |
| Emerging Markets                | MSCI Emerging Markets       | 2.11          | 77.26          | Cat: Divers. Emerging Mkts                        | 2.84          | 81.59          |

<sup>1</sup> In some cases, where published indices are not readily available, the performance of an appropriate passively managed mutual fund is used as a proxy.

<sup>2</sup> In cases where Morningstar does not provide meaningful category data, we extract averages from the fund database to use for performance tracking and comparison.  
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