

EDUCATED INVESTOR

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A Measure of Happiness

Do you know what it takes to make you happy? A simple enough question, but as it turns out, not always so easily answered. At least not according to Daniel Gilbert, Harvard professor of psychology and author of *Stumbling on Happiness* (Alfred A. Knopf, a division of Random House, copyright © 2006).

Drawing on scientific research in fields of study ranging from behavioral economics to cognitive neuroscience, Gilbert demonstrates how our mind can often play tricks on us. We tend to “cook” our memories to inaccurately measure past happiness or sorrow. We also inaccurately predict how happy or sad we’ll be in the future. It may be hard to accept, but the best time for realistically assessing your level of satisfaction may be limited to *right now*.

In the grand scheme, Gilbert notes that these tricks are often in our best interest. They enable us to recover from past trauma. They keep us resilient and a bit



optimistic. They help us look forward to raising our children and building our careers, glossing over details like diapers and daily grinds.

But when it comes to planning your financial future, your brain may not always be your best friend.

Instead, thanks to our survival instincts, it seems we are predisposed to making all sorts of investment mistakes.

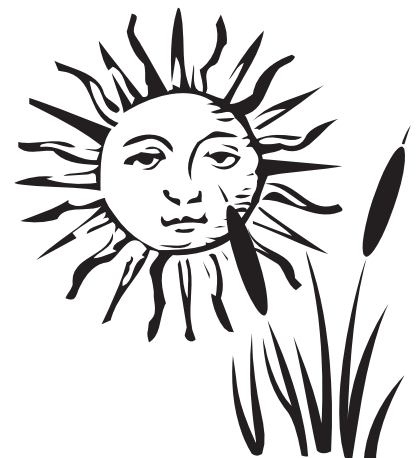
Gilbert observes that the most reliable predictor of how you’ll feel about a future experience may be the more accurate observations of someone who is currently experiencing it.

He concludes: “Foresight is a fragile talent that often leaves us squinting, straining to see what it would be like to have this, go there, or do that. There is no simple formula for finding happiness. But if our great big brains do not allow us to go surefootedly into our futures, they at least allow us to understand what makes us stumble.”

That’s where a relationship with a trusted investment advisor can add a lot of value. Working with someone who:

- ▲ Is dedicated to understanding a wide array of investors’ real-time experiences
- ▲ Continuously and empirically assesses what has and has not worked well for others
- ▲ Constantly and consistently reminds you how you can benefit from the wealth of others’ experiences (and why you can’t always trust that lone voice in your head)

How do you select an ally whose advice is reliable? In this issue of *The Educated Investor*, we will share 11 principles we have adopted for serving our clients. We’ll also review a few “mind games” that too often lead well-intentioned investors astray. Finally, we’ll share with you one of our favorite parables about how to seek true happiness in life.



Choosing a Trusted Advisor

Following are 11 principles we've adopted to help us serve as a trusted advisor.

Act in the best interest of the client

We provide advice and recommendations that are in the client's best interest. Period. Not because we are legally obligated to (although we are). Not because it works well as a business model (it does). Simply because it is right. Our remaining goals are selected to achieve this first and foremost guiding principle.

Follow a fiduciary duty standard of care

Pursuant to the Investment Advisors Act of 1940, we follow a fiduciary duty standard of care. This is the highest legal duty of care for a client's welfare, and one we gladly accept — in contrast to the less-stringent "suitability standard."

Deliver attentive, individualized service

We provide a high level of personal attention. We make a point of getting to know each client and of learning what is important to him or her. Developing personal-

ized insight is key to providing appropriate advice and service.

Build customized, integrated investment plans

We develop investment plans that relate to the whole person or whole family — plans that are integrated into each client's unique strategy and personal situation.

Achieve goals and experience long-term success through strategic advice

Our advice is goal-oriented, whether the goals are imminent or long-term. We evaluate and make recommendations for achieving them. We also fit each independent objective into the context of achieving an overall investment plan.

Offer a team for each client

Each client benefits from a team of professionals. Using in-house expertise or carefully selected alliances as warranted, we offer a range of resources to help clients make sound investment decisions.

Focus on professional advice, not on products

We are client-centric, which means we focus on delivering sound advice and targeted

solutions. The only incentive we have in offering particular solutions is whether the client's best interest will be served.

Serve as a fee-only advisor

We are a fee-only advisor — avoiding any conflicts or bias that commissioned-based compensation can create.

Practice full disclosure and seek transparent costs

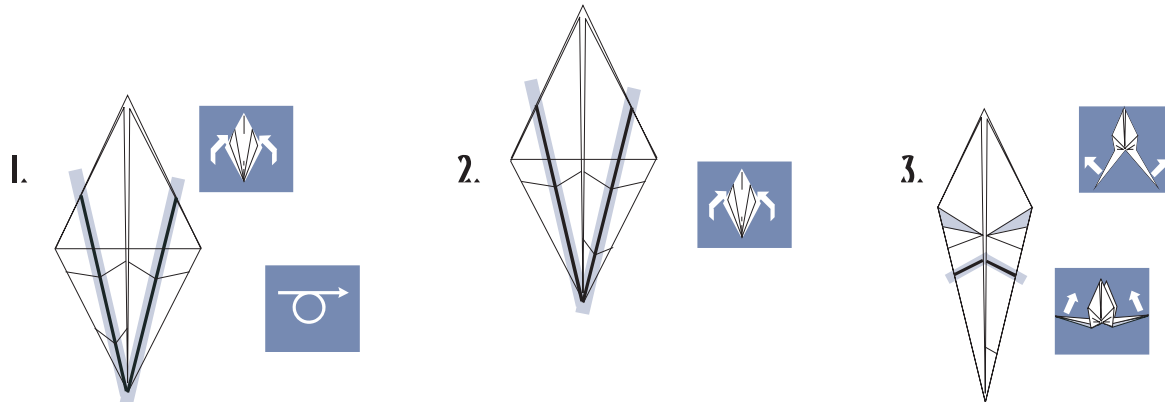
Potential conflicts of interest as well as any costs incurred are fully disclosed and clearly explained. We give answers in plain English, with whatever level of detail the client seeks.

Take advantage of academic research

While we strive for our advice to be straightforward and understandable, we base it upon the latest, peer-reviewed academic evidence.

Practice what we preach

We invest our personal assets based on the same set of investment principles and using the same or comparable securities that we recommend to our clients.



Mind Over Money

Behavioral finance is the academic inquiry into why investors often act in seemingly irrational ways. Or, as co-authors Gary Belsky and Thomas Gilovich more casually phrased it: *Why Smart People Make Big Money Mistakes* (Simon & Schuster, copyright © 1999).

Specialists in behavioral finance have identified several human traits that can hurt investment returns. These traits have been around for quite some time, with no sign of dissipating. For example, here is a list that appeared in a 1997 *Institutional Investor* column. It remains as important today as it did then to be aware of these potential foibles to your long-term financial goals:

- ▲ Seeing “order where it doesn’t exist and [interpreting] accidental success to be the result of skill”
- ▲ Becoming overconfident in areas where knowledge is minimal (“a little knowledge is a dangerous thing”)
- ▲ Seeing other people’s decisions as a result of mood and temperament, but seeing

your own as a result of objective and rational thought

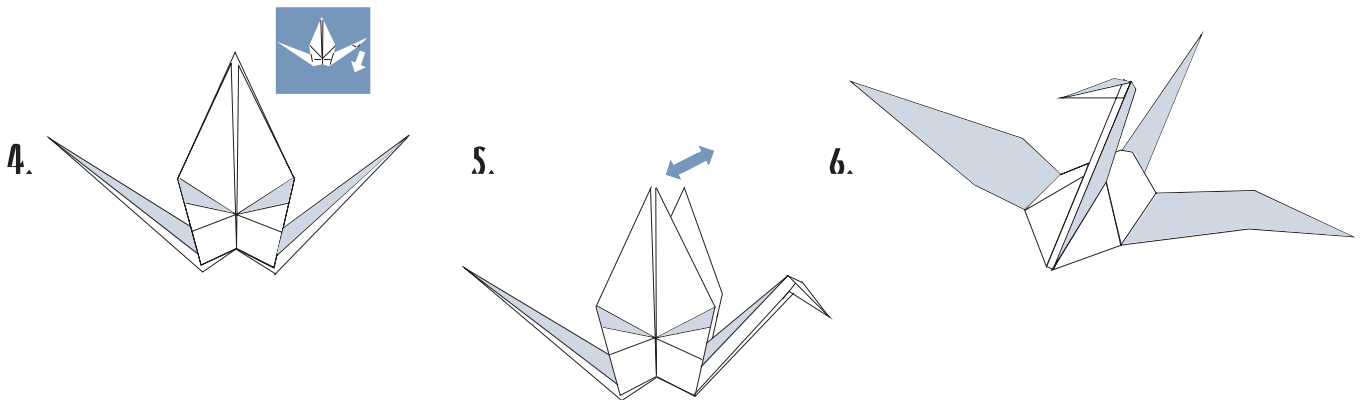
- ▲ Treating “the highly probable as certain and the improbable as impossible,” thus inaccurately assessing investment risk
- ▲ Placing too much emphasis on recent experience, so that recent gains lead to overconfidence and recent losses to excessive caution — for example, after a relatively strong year for the S&P 500 Index, thinking that large-cap stocks are the best investments and that international stocks are poor investments
- ▲ Refusing to change long-held opinions after overwhelming new information contradicts those opinions
- ▲ Succumbing to bias by hindsight — typically by more easily remembering investment successes than failures
- ▲ Being influenced by the “herd mentality” — assuming something is right just because it is group consensus

We can all learn much from being aware of such tendencies. Minimizing our emotional responses is an important part of a prudent investment process.

Daniel Kahneman, professor of psychology and public affairs at Princeton University, received the 2002 Nobel Prize in Economics for his contributions to behavioral finance. His advice to investors tuning in to CNBC the day after his Nobel was announced was, “Buy and hold.”

In a 2001 *Money* article, Kahneman proposed why investors persist in searching for abnormal returns that often just aren’t there: “In a rising market, enough of your bad ideas will pay off so that you’ll never learn that you should have fewer ideas.” He added, “All of us would be better investors if we just made fewer decisions.”

We believe that working with your trusted advisor to form a written investment policy statement (IPS) is integral to a successful long-term investment experience. Discuss in advance and build into your plan the possibility of downturns as well as upswings. Be prepared to remain disciplined and adhere to your carefully constructed plan when turbulence occurs. By creating an IPS that is devoid of emotional pitfalls — premised on your recognizing such pitfalls — you can better maintain the discipline you need to achieve your goals.



First Things First

If you're a human being, you've no doubt wasted plenty of days on petty details, with little time left to spend on what really matters. At right is a common parable we like to share — the Parable of the Big Rocks. It helps us avoid losing sight of our priorities, particularly when it comes to selecting an appropriate, life-long investment approach. ►

What are the "big rocks" in your life? Time with your loved ones? Your children's education? Your own dreams or your career path? Whatever they are, the point is to make room for these items first.

Individual investors who follow an active management strategy tend to spend time trying to pick winning stocks or determine where the market is headed next. For example, they must watch the latest business news, study charts, review Web sites, or read financial trade publications and newsletters. Then they must decide how best to act on all the information they're receiving.

With such an approach it's difficult to form a consistent plan on exactly how to achieve one's financial goals. How can you, when none of us knows what the next winning and losing stocks are going to be?



The Parable of the Big Rocks

Once upon a time, a time management specialist was speaking to a group of business students. In the middle of her presentation, she placed a big mason jar on the table next to her and began filling it with large, lemon-sized rocks.

When no more rocks would fit, she asked the group, "Is this jar full?"

Everyone yelled, "Yes!"

She pulled a bucket of gravel from under the table and dumped some into the jar, shaking it. This caused pieces of gravel to move into the spaces between the big rocks.

She asked again, "Is the jar full?"

One of the students guessed, "Probably not."

The speaker retrieved a bucket of sand from under the table and dumped it into the jar. Sand filled all the spaces left between the rocks and the gravel. Once again she asked, "Is the jar full?"

By now, everyone responded, "No!"

Finally, she filled the jar with water. Now, it was full.

She asked the students what the point was of the demonstration. Since the lesson was concerning time management, one student guessed, "No matter how full your schedule is, you can always fit more things in?"

The speaker replied, "No, that is not the point. This demonstration teaches us that if you don't put in the big rocks first, you'll never get them into the jar at all."

In effect, active investors are concentrating on the gravel, sand and water, and leaving no room for the big rocks.

As a passive investor, you can focus on **asset allocation**, which is by far the most significant determinant of investment returns. With the help of a trusted advisor, you can determine an asset allocation that makes sense for you. You can construct a diversified, global portfolio that captures

that allocation; and then you can implement periodic, disciplined rebalancing to maintain that allocation through all types of markets.

In taking these simple steps, you have built a major foundation for achieving your long-term financial goals. Best of all, this leaves the rest of your time to spend on the big things in your life that really matter.

Our Basic Tenets

Our objective is to design portfolios using passive asset class funds that maximize investors' returns within their tolerance for risk. Here is what sets us apart:

- ▲ Fee-only investment management
- ▲ A disciplined investment strategy
- ▲ Access to institutional no-load passive asset class funds
- ▲ Fixed income expertise

- ▲ An investment approach based on research by Nobel Prize-winning economists
- ▲ Continued access to academic research
- ▲ A tax-efficient focus, with valuable tax and estate-planning ideas
- ▲ Risk tolerance assessment
- ▲ Periodic portfolio rebalancing
- ▲ Regular communications and state-of-the-art reporting
- ▲ **MOST IMPORTANT ...**
A TRUSTED ADVISOR RELATIONSHIP