FALL 2012

WEALTH STRATEGY FROM A DIFFERENT PERSPECTIVE

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The Science of Investing

The amount of research on financial markets and investing rivals that of medical research. Largely starting in the 1950s, finance began its transition from a neglected area within economics to a legitimate field of study.

Looking back, we can now identify many seminal pieces of research that have fundamentally changed investing. Two that continue to have influence are Eugene Fama and Kenneth French's 1992 paper "The Cross-Section of Expected Stock Returns" and Mark Carhart's 1997 paper "On Persistence in Mutual Fund Performance." Fama and French's paper documented the historical outperformance of small-cap stocks compared with large-cap stocks and value stocks relative to growth stocks. Carhart's paper found that most mutual fund managers underperformed the market and that few persistently outperformed it.

Today, newer areas of stock market research are being explored. This research indicates that stocks that have done well over the past year tend to do well over the next six months and that profitable companies tend to outperform less profitable companies. Termed the momentum premium and profitability premium, both may well affect how portfolios are diversified in the future.

Planning in an Uncertain World

For the majority of 2012, events both economic and political have left Americans with more questions than answers. Most investors would agree that recent times have been fraught with uncertainty. How should we approach the uncertainty associated with financial matters, such as what will tax rates be in 2013, or when and how will the Eurozone crisis be resolved? Investors can approach this from three different perspectives.

First, without uncertainty, investors could not expect to be rewarded. Imagine a world where we all knew exactly the earnings that companies would generate and how the global economy would do in 2013. In this fictional world, risk has been eliminated and, with it, reward. A large part of the reason why stock market investors have been rewarded over most longer periods of time is because stock prices incorporate the possibility that downside risks may show up. The longest evidence that we have, covering 1900–2010, shows that stocks have outperformed bonds by 5.9 percent per year.

Second, focus your energy and time on the elements of uncertainty that matter and can be controlled. On the investing side, these include whether your portfolio is well diversified, its tax efficiency and how much risk you have chosen to take. It does not include speculating whether stock markets or interest rates will be up or down in a year and adjusting your portfolio accordingly.

On the planning side, factors include properly titling your assets and ensuring that your estate plan reflects the goals that you have for your wealth. When investors focus their effort in these areas, the end result is better wealth management outcomes more often than not.

Finally, investors can turn to academic and practitioner research to reduce investment uncertainty. For example, there is research that has found value in modestly extending the maturity of the bonds in a portfolio when interest rates are significantly higher on intermediate-term bonds compared to short-term bonds. This advice may seem counterintuitive because interest rates have generally been low, and it certainly flies in the face of many articles published in the past few years. This is just one example of applying investment science to reduce uncertainty. This quarter's sidebar "The Science of Investing" outlines other ways to apply the science of investing to a portfolio.

The journey to find clarity may continue into 2013. Still, the personal and financial goals you have set do not change because the world around you is in flux, unless you decide to change them. One thing is certain: Your goals and the investment plan built to accomplish them are still standing firm against whatever lingering doubts remain.

The Top 10 Money Excuses

By Jim Parker

Human beings have an astounding facility for self-deception when it comes to our own money. We construct the façade of a logical-sounding argument, which is often an elaborate, short-term excuse that we use to justify behavior that runs counter to our own long-term interests.

Here are 10 of these excuses:

1) "I just want to wait till things become clearer."

It's understandable to feel unnerved by volatile markets. But waiting for volatility to "clear" before investing often results in missing the return that can accompany the risk.

2) "I just can't take the risk anymore."

By focusing exclusively on the risk of losing money and paying a premium for safety, we can end up with insufficient funds for retirement. Avoiding risk can also mean missing an upside.

3) "I want to live today. Tomorrow can look after itself."

Often used to justify a reckless purchase, it's not either-or. You can live today *and* mind your savings. You just need to keep to your budget.

4) "I don't care about capital gain. I just need the income."

Income is fine. But making income your sole focus can lead you down a dangerous road. Just ask anyone who recently invested in collateralized debt obligations.

5) "I want to get some of those losses back."

It's human nature to be emotionally attached to past bets, even losing ones. But, as the song says, you have to know when to fold 'em.

6) "But this stock/fund/strategy has been good to me."

We all have a tendency to hold on to winners too long. But without disciplined rebalancing, your portfolio can end up carrying much more risk than you bargained for.

7) "But the newspaper said ..."

Investing by the headlines is like dressing based on yesterday's weather report. The news might be accurate, but the market usually has reacted already and moved on to worrying about something else.

8) "The guy at the bar/my uncle/my boss told me ..."

The world is full of experts, many who recycle stuff they've heard elsewhere. But even if their tips are right, this kind of advice rarely takes your circumstances into account.

9) "I just want certainty."

Wanting confidence in your investments is fine. But certainty? You can spend a lot of money trying to insure yourself against every possible outcome. While it cannot guard against every risk or possible outcome, it's cheaper to diversify your investments.

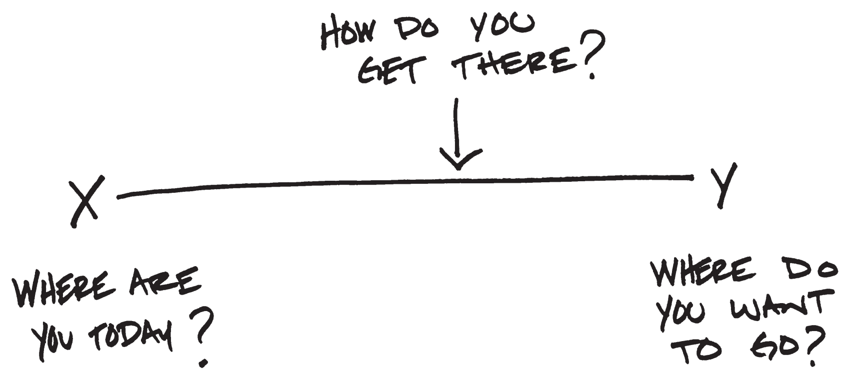
10) "I'm too busy to think about this."

We often try to control things we can't change — like market and media noise — and neglect areas where our actions can make a difference — like the costs of investments. That's worth the effort.

Jim Parker is a vice president at Dimensional Fund Advisors in Sydney, Australia. Jim spent 25 years in journalism and served as a senior editor for the *Australian Financial Review.* He holds an economic history degree from Deakin University and a journalism degree from Auckland Technical Institute.

Perspectives

Perspectives features different topics of interest that offer viewpoints on improving quality of life. This quarter, Carl Richards, author of *The Behavior Gap* (2012) and director of investor education for the BAM ALLIANCE, discusses the process of getting from X to Y.



BehaviorGap.com

Goals are important, but sometimes, we get so attached to goals that we forget to live. When that happens, it is beneficial to find a healthy balance between living the goal and living life.

The process of wealth management involves setting goals, establishing a direction and making decisions to head that way. That's how we get where we want to go.

Nationally Recognized

For the third consecutive year Siena Wealth Advisors has been recognized by the national publication Accounting Today/CPA Wealth Provider. Siena is one of three Michigan based firms on the list and the only one outside the metro Detroit area. We are proud that our continued work of providing comprehensive wealth management based on sound evidenced based investing principles does not go unnoticed.

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