March 2015

About Beacon Financial Advisors Ltd.
Beacon is an independent fee-only advisor with a clear mission statement: To provide our clients long-term value-added financial counsel and investment performance with *exceptional service.* **Beacon** is a Registered Investment Advisor with the US Securities and Exchange Commission.

Beacon's Advisors
MARCEL HEBERT has a B.S. in Finance, an M.B.A., and is a Certified Financial Planner (CFP) licensee and a Chartered Financial Analyst (CFA) charterholder.

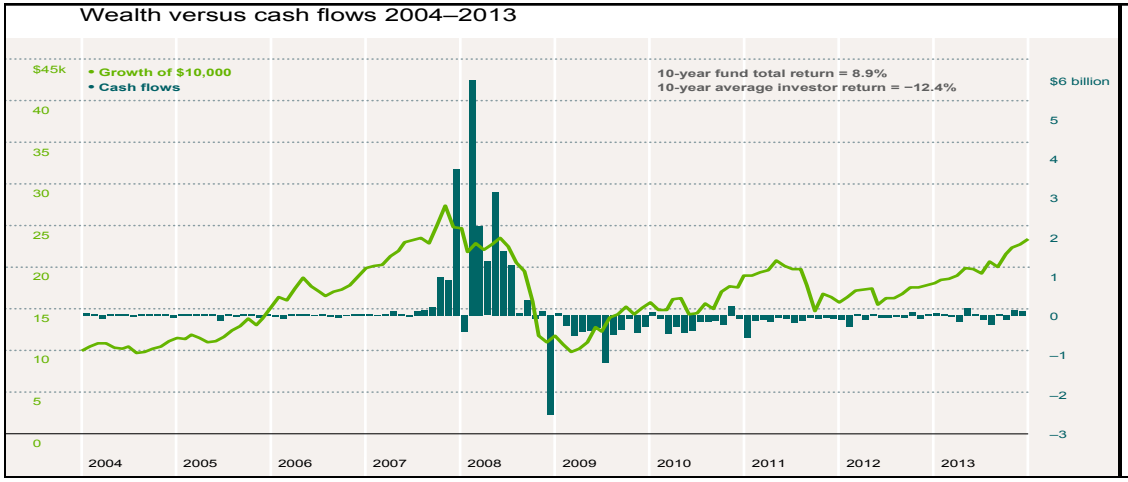
JOSH HEBERT has a B.S. in Accounting, an M.B.A., and is a Certified Internal Auditor (CIA) and a Certified Financial Planner (CFP) licensee.

CHARTING THE COURSE

Special Series of Briefs About Beacon's Client Services

HUMAN BEINGS MAKE LOUSY INVESTORS...*Except When We Don't!*

With apologies to fans of World Cup soccer, this writer doesn't' get it—Team A defeats Team B, ties Team C, loses to Team D, and advances to the next round. Perplexing as that seems, it reminds **BEACON** how investing often is confusing even to some of our clients. And why not? Sometimes stocks decline after "good" news, or rise in the face of "bad" news (e.g. climbing "walls of worry"). In fact, "headline" news is a terrible barometer for investing signals. For example, consider a recent scenario in which the US Bureau of Economic Analysis ("BEA") made numerous revisions to quarterly US economic output, finally landing at –2.9% (a very large economic contraction). The "headline" news announced the US was in danger of re-entering recession. And yet, the S&P 500 Index advanced over 5% that quarter so clearly the stock market didn't get the memo from the BEA. The "headline" business and economic news rarely provides sufficient context for investors to make informed investment decisions. As the chart and inset below illustrate, we humans make lousy investors because we buy and sell at the wrong times. And, much financial journalism facilitates our poor results with their unsolicited "advice". *(continued p 2)*



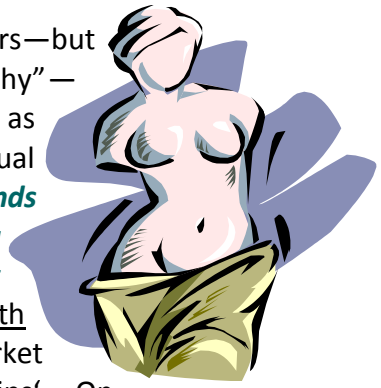
HEADLINE NEWS AND INVESTOR BEHAVIOR

The image illustrates the divergence in total return and investor return for a mutual fund selected from Morningstar's open-end fund database. The fund's 10-year total return was 8.9%, but its 10-year investor return was –12.4%; quite a difference. The fund's net cash flow tells the story of the discrepancy. Investors piled into the fund during its run-up, with most inflows occurring near the investment's peak. Investors then fled as the fund's returns plummeted, with most outflows occurring near the investment's bottom. In fact, investors were still leaving the fund as it rebounded and consequently were not around to recoup some of their losses.

"...headline" news is a terrible barometer for investing signals..."headline" business and economic news rarely provides sufficient context for investors to make informed investment decisions."

Beacon Financial Advisors, Ltd.

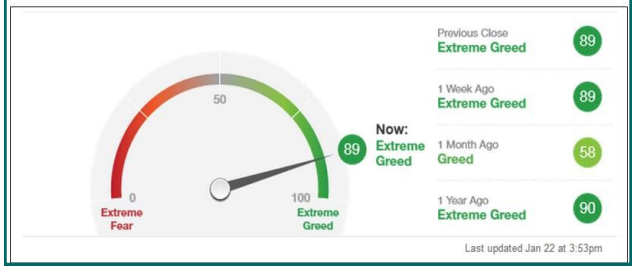
HUMAN BEINGS MAKE LOUSY INVESTORS...*"Investment Pornography" and FEAR & GREED!*



Investment Porn? We know our SERVICE-BRIEFS are family newsletters—but **BEACON** didn't coin the term "investment pornography"—Jane Bryant Quinn wrote about it in her NEWSWEEK article "The Big Tease" (8/7/95). And what did Ms. Quinn refer to as Investment Porn? The proliferation of popular personal finance magazines wherein reporters pick stocks and mutual funds for readers thirsting for investment advice—any advice, it seems—***"You know the stories: The Top Ten Mutual Funds to Buy Now, How to Double Your Money This Year, personality profiles that read like fan magazines. Stock-touting pieces that praise any path to profits. We've all done these stories, in one form or another. It's investment pornography -- soft core, not hard core, but pornography all the same."*** Does any of this have anything to do with prudent financial advice? Can the investing public discern what's tossed at them? MONEY magazine warns against market -timing, but plasters a cover with SELL STOCKS NOW! Others promote long-term investing, yet pump monthly stock 'tips'. On the positive side, these sources may serve to convince consumers to start saving and investing early, and use stocks for growth. A worthy thing indeed. Yet, not all of popular consumer finance is useful, according to some experts. The late Merton Miller, a Nobel laureate, once wrote ***"investment advice from journalists is part of the entertainment industry"***. The very prestigious academic finance publication Journal of Finance agrees, writing ***"much of personal finance is pure amusement".*** Where does **BEACON** stand on this issue? If reporters and journalists are to give investment advice, they should agree to register with the SEC as investment advisers and report their investment performance. Otherwise, caveat emptor- Let the buyer beware!

So, humans make lousy investors and much financial journalism contributes to the problem. But what is it about humans that seems to confine us to this plight?—the omnipresent all-to -human emotions of **FEAR** and **GREED**! This emotion-cycle is so well known by WALL STREET pros that many are successful using "contrarian" investing—buying what retail investors are selling and selling what they're buying (see Warren Buffet p. 4). There are even indexes that calculate and measure FEAR and GREED. As "consumers", we love a sale and hasten to the malls when prices are 40% off. Saavy shopers often buy "out of season"—leather jackets are expensive in September but 50% off in March! And yet, as "investors" if the stock market has a 40% off sale, we react in an entirely opposite manner—sell (**FEAR**)! Then, after the eventual recovery of stock prices these same "investors" are inclined to buy at full-price—(**GREED**).

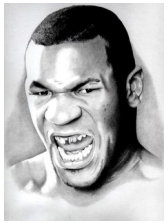
Fear and Greed Index: Extreme Greed



So, what if you're one of those "look-in-the-mirror" humans that concedes the dreaded **FEAR** and **GREED** cycle is real? Well, you simply make a plan and play-it-by ear—seems reasonable. That should work, right? Well, let's ask Iron Mike Tyson.

(continued p 3)

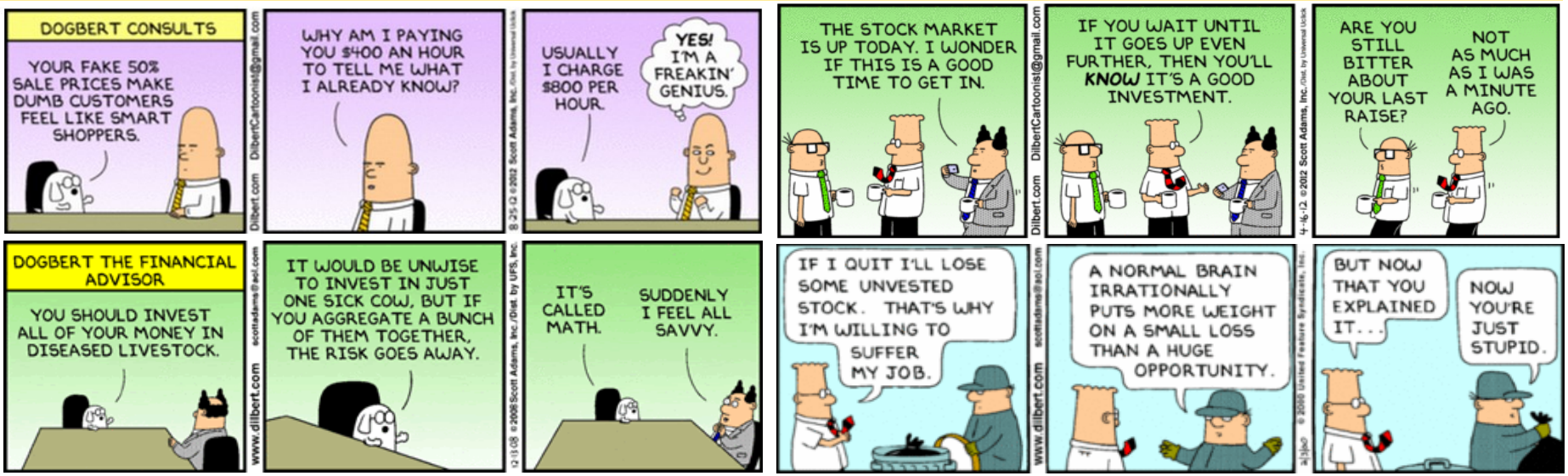
HUMAN BEINGS MAKE LOUSY INVESTORS...*Mike Tyson & Dilbert on "Behavioral Economics"*



Modern day philosopher Mike Tyson once said, ***"Everyone has a plan 'til they get punched in the mouth."*** Iron Mike's answer was in response to a sportswriters' question about the tactics his boxing opponent was likely to deploy. Iron Mike's terse reply spoke volumes about how he would counter his opponents "plan". The stock market's version of a Mike Tyson "punch in the mouth" is a bear market of declines in values of 20% or more.

In recent decades noted economists, including Nobel winner Daniel Kahneman and his late colleague Amos Tversky, have advanced new fields of study called behavioral economics and behavioral finance. These fields use psychological insights to inform economic theory. For instance, "classical economics" held that people are rational decision makers with a firm grasp on self-control. In contrast, "behavioral economics" informs that people are not as logical as previously thought. Related to humans as decision makers (i.e. in finance, investing), behavioral economics and finance focus on the important role of emotion and intuition, and how our emotions often leads to systematic and predictable errors. Cartoonists help to frame important issues—a picture is worth a thousand words. *(continued p. 4)*

Dilbert Does Behavioral Economics https://www.psychologytoday.com/blog/markets-in-mind/201401/dilbert-does-behavioral-economics?



"Everyone has a plan 'til they get punched in the mouth." IRON MIKE TYSON, PROFESSIONAL BOXER

HUMAN BEINGS MAKE LOUSY INVESTORS...*Bind Me to the Mast!*

Ulysses (of Greek Mythology) sought safe passage by the coast of the Sirens (nymphs with power of charming by their song such that mariners cast themselves into the sea to destruction). Lest they succumb to the beauty of the Sirens song, Ulysses plugged the ears of his seamen with beeswax, and had himself bound to the mast with instructions not to release him until they passed the Siren's island. So beautiful was the Siren's music that Ulysses struggled and begged to be released, but his seamen were obedient to his prior command and bound him even more secure. They held their course, the Siren's music grew fainter until silent, and Ulysses and his men joyfully returned home in triumph.

Ulysses would have made a fine investment advisor. At least that's the assessment of the folks at Allianz Global Investors in their 2011 white paper Behavioral Finance in Action: Psychological challenges in the financial advisor/client relationship and strategies to solve them. The 4-page chapter Reigning In Lack of Investor Discipline: The Ulysses Strategy is prefaced by a text from Warren Buffet: ***"Investors should remember that excitement and expenses are their enemies. And if they insist on trying to time their participation in equities, they should try to be fearful when others are greedy, and greedy only when others are fearful."***

The Ulysses Strategy is described as a "contract" or decision made in the present to bind oneself to a particular course of action in the future—a "bind me to the mast" concept. **BEACON** refers to this as a written Investment Policy Statement ("IPS")—and we prepare an IPS for each of our clients. In our 20-page white paper Balanced, Global Portfolios Using Mutual Funds, we detail the merits of a written IPS to help our clients succeed (p. 5). There are always plenty of Siren's songs enticing investors to deviate from course and fall victim to the dreaded emotional **FEAR / GREED** cycle. **BEACON** has long espoused that successful investing—buy low(er) and sell high(er)—requires a keen understanding about what works in investing (i.e. a proven investing strategy), and patience for the payoff. If we help our clients write and adhere to investment policies (aka the Ulysses Strategy), is there evidence that it really works? Yes, indeed we have lots of actual historical client evidence. For more explanation turn the page and **bind me to the mast!** *(continued p. 5)*

Features of a Written Investment Policy Statement (IPS)

The key areas for information gathering can be categorized as *objectives* and *constraints*:

Client Objectives	Client Constraints
• Return	• Need for Liquidity
• Risk	• Income Requirements
	• Time Horizon
	• Tax Considerations
	• Legal and Regulatory Issues
	• Personal Preferences

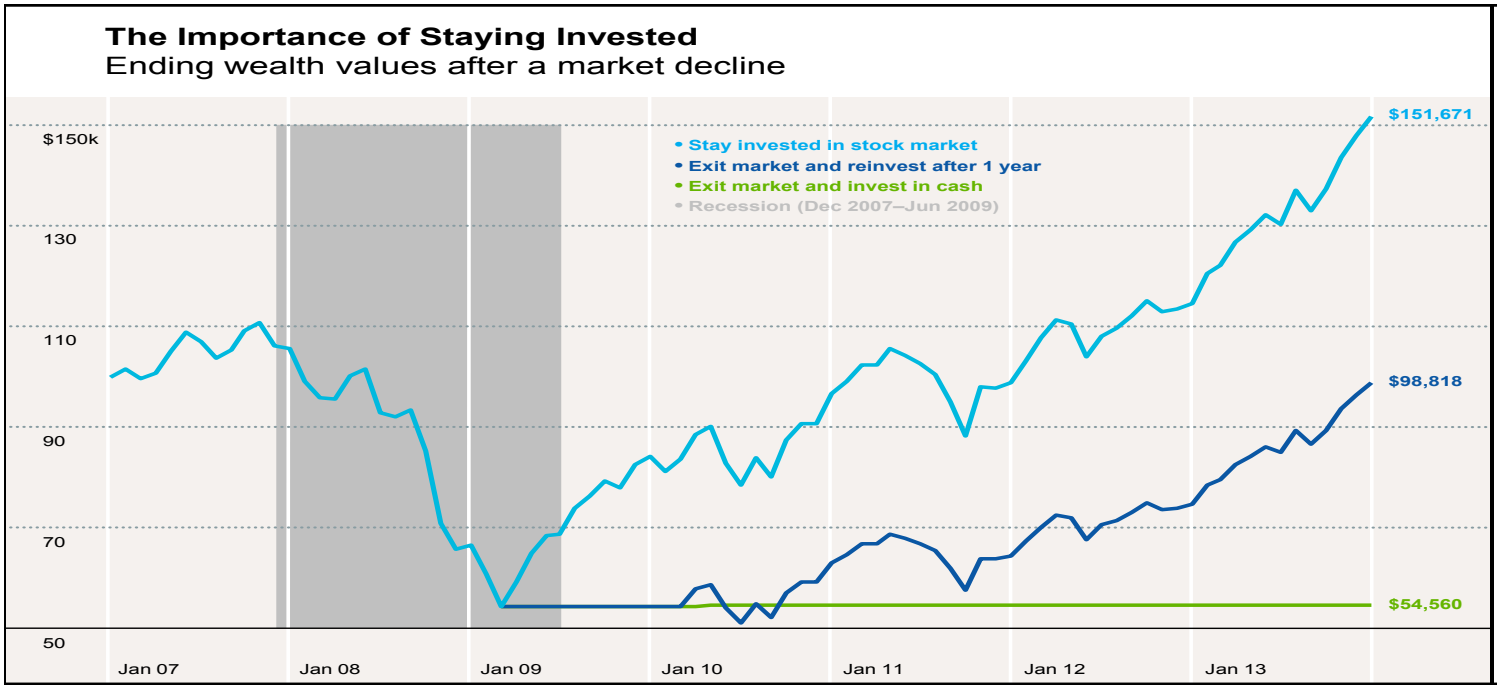
"Investors...should try to be fearful when others are greedy, and greedy only when others are fearful." Warren Buffet 2004 Chairman's Letter

HUMAN BEINGS MAKE LOUSY INVESTORS...*Endeavor to Persevere!*

per·se·vere - to continue doing something or trying to do something even though it is difficult in a state, enterprise, or undertaking in spite of counterinfluences, opposition, or discouragement. MERRIAM-WEBSTER

On March 9, 2009 the S&P 500 Index hit bottom at an intra-day low of about 666, down over 50% from October , 2007. Six years later the S&P 500 topped 2,200 in early 2015, a 200% recovery. An what did most human investors do? They followed the same **FEAR** and **GREED** cycle of selling low and buying high as discussed on p. 1 and depicted in the chart and inset below. Sadly, those investors made permanent their losses.

In the midst of the "Great Recession" all through 2008 and into early 2009, "market stress" ensured lots of difficult days and sleepless nights for our clients and **BEACON**. We're thankful for the recovery of client-portfolio values. It is crucial to remember that successful investing tests our resolve and demands perseverance. Our clients had the perseverance to adhere to their investment plans and, as a result, their "paper" losses were fully recovered. We all learn from past experiences, and while the "Great Recession" was a period some would like to forget (especially those that had permanent losses), we know there will again be stressful times when those hard-learned lessons will need to be reapplied. Balanced, global portfolios based on client-goals remains **BEACON's** recommendation!



PERSEVERANCE PAYS OFF

The image illustrates the value of a $100,000 investment in the stock market during the period 2007–2013, which included the global financial crisis and the recovery that followed. The value of the investment dropped to $54,381 by March 9, 2009 (the trough date), following a severe market decline. If an investor remained invested in the stock market over the next 58 months, however, the ending value of the investment would be $151,671. If the same investor exited the market at the bottom to invest in cash for a year and then reinvest in the market, the ending value of the investment would be $98,818. An all-cash investment at the bottom of the market would have yielded only $54,560.