SUMMER 2012

in Context

WEALTH STRATEGY FROM A DIFFERENT PERSPECTIVE

Pritchard Osborne Financial Services, LLC

Putting the Global Economy and Markets in Context

The financial and economic environment of the past few years has been challenging. To name just a few headline-grabbing items, investors have had to stare down a ratings downgrade of U.S. Treasury bonds by Standard & Poor's, the European debt crisis (see sidebar on this page), high unemployment report after high unemployment report and very low rates of interest on bond investments. With all of these stories, which are incessantly focused on negative developments, it can be easy for investors to miss the good news. With the turbulent financial markets of 2008 and early 2009 now several years past, we can begin to put these developments in context.

Over the period of 2009 through June 2012, stock market investors and fixed income investors have generally experienced great results if they had the discipline to the stay the course and implement sensible, low-cost strategies. The S&P 500 Index is up 63 percent over this period, and five-year Treasury bonds have returned 15 percent. No doubt there have been some periods of high volatility, but the investment results have been much better than one might guess given the headlines mentioned above, and they reinforce the importance of maintaining discipline regardless of environment.

Those who have studied the long-term histories of financial markets and global economy have noted how similar the aftermath of the 2008 financial crisis has been to other financial crises of similar magnitude. In their 2009 book, *This Time Is Different: Eight Centuries of Financial Folly*, professors Carmen Reinhart and Kenneth Rogoff found it is not uncommon to see substantial depreciation of real estate prices and stubbornly high unemployment following financial crises. While this information doesn't necessarily provide comfort to those that have had difficulty finding work or been directly affected by the 2008 financial crisis, it does show the world has been through similar episodes and that it has ultimately recovered.

Looking forward, there are positive aspects to highlight as well. Even though fixed income rates are low, expected returns on diversified stock portfolios are well within the historical norm. Risks could materialize, but market pricing appears to have accounted for those risks. As one example, international stocks have fallen by more than 13 percent over the year ending in June 2012, which is exactly what you would expect to see as the risks associated with the European debt crisis became evident to the marketplace: Prices adjusted downward, and expected returns were therefore adjusted upward.

An Update on Europe

The second quarter saw numerous important developments in Europe. In mid-June, Greece held elections that were won by pro-bailout parties, which eased fears that Greece exiting the Euro currency was an imminent possibility.

Further, an agreement was reached to supply Spain with approximately $125 billion to help recapitalize its banking system. It is important to note, though, that these funds will have to be paid back and will add to the debt burden facing Spain's government. Finally, the most recent development of note was an agreement to allow the Eurozone rescue funds to directly recapitalize banks.

There are still many details to be worked out to put the framework of this agreement into practice. Also, it is not yet clear whether this most recent agreement will affect the terms of Spain's bailout. What remains clear is there are no easy fixes to the troubles of Europe, which faces a long road to economic recovery.

Determinants of Happiness

By Thomas Gilovich

Which purchases give people the greatest satisfaction? The answer is likely to be different for a married couple in their 20s than for a recent retiree. Nevertheless, a very clear guideline has emerged from our recent research on the determinants of happiness: Spend your money on experiences.

That is, if you're conflicted about whether to buy a material good (a new sofa or the latest electronics) or to finance a personal experience (a trip to Europe or tickets to a play), research has found that you'll get more satisfaction — and much more enduring satisfaction — if you choose the experience. For example, when people were asked to recall their most significant material purchase and their most significant experiential purchase over the past five years, they reported the experiential purchase brought them more joy and enduring satisfaction, and it was clearly "money well spent" compared with the material purchase.

Many people find this surprising. When faced with an experiential-material trade-off (such as, take the kids to Yosemite or trade in the old car for this year's model), many people convince themselves they should opt for the material good because "it will still be there" long after the experience would have been enjoyed. That's correct in a purely material sense, but psychologically, it's the reverse. We quickly habituate to the material good: The new car is fun for a while, but soon it feels no different than the car you traded in. The experience, however, tends to live on. It persists in the memories we cherish, the stories we tell and the very sense of who we are.

Experiences are often more satisfying because we tend to evaluate them on their own terms, not in comparison with what others have. Imagine you've just come back from 10 days in New Zealand to learn that a neighbor spent less money for two weeks there in undeniably superior accommodations. This wouldn't be pleasant to hear, but chances are you'd get over it quickly. You have your memories, your photos and your time with loved ones — experiences you'd be unwilling to trade for your neighbor's nominally superior trip.

Essential items aside, if you are torn between a material good and an experience, don't make the material purchase based on the argument it will last longer. Instead, opt for the experience. Our research has shown that people's most common regrets over material goods are regrets of action — buying something that now seems unwise or impulsive. Their biggest regrets about experiential goods tend to be the opposite — regrets of inaction, or not seizing an experiential opportunity that presented itself.

Thomas Gilovich is a professor of psychology at Cornell University. He has written more than 100 articles for professional and academic journals, including several articles published in 2010 on experiential and material purchases. He co-authored the book *Why Smart People Make Big Money Mistakes — and How to Correct Them* (2nd edition, 2010). Gilovich holds a PhD from Stanford University and a bachelor's degree from the University of California, Santa Barbara.

Perspectives

This quarter, *Perspectives* features an interview with Carl Richards, author of *The Behavior Gap* (2012). Carl became an accidental artist with his simple sketches that make complex financial concepts easy to understand.

Q. Why did you begin to draw sketches?
A. Talking with investors, I began to notice how their eyes would glaze over as I tried to describe investment theory. One day, I drew a few shapes to explain the concepts, and the conversation changed. I kept drawing sketches, and that led to one sketch a week for *The New York Times* and then the book. I had no idea how strong the reaction would be.

Q. Having meaningful conversations about money is prevalent in many of your sketches. Why do we overlook the value of having good conversations?
A. Most of the topics surrounding money are emotional, but we expect it to be like learning an equation or reading a spreadsheet. What we're really talking about is freedom, flexibility, security, peace of mind and our most cherished dreams for ourselves and our family.

We don't have these conversations often because when we touch these topics, it's like touching the third rail, we get shocked. Try setting aside a regular time and place to have such conversations. Once a month, go to a café no one likes and have a discussion to review goals and go over new issues. Slowly, the conversation will change from heated discussions **around** money to discussions **about** money.

Q. In your book, you relate a story in which you decide to give away your collection of specialized skis in favor of one pair that has consistently served you well. How did you arrive at this decision, and how does it translate to money and investing?
A. I live in an area where we take skiing pretty seriously. It's not unusual for someone to have three or four pairs of skis for different conditions. After years of following what everyone else does, I found that I didn't like that approach.

What I like to do is grab a pair of skis and go. For me, the enjoyment is the skiing. For other people, part of the enjoyment is that process of looking at the conditions, deciding which pair of skis to use and going out to test that assumption.

The story is really about the why of money: Why am I investing this way? Why am I saving for this? Is it right for me? We need to start questioning some of our assumptions about why we do certain things and what it is that actually makes us happy. It's about asking why.

Q. Are people wary of simplicity in their lives?
A. We say we want things simplified. But how often are people disappointed when the doctor's only prescription is to go home, get some rest and take some over-the-counter medication?

When we are dealing with big, important decisions and the answer is simple, we sometimes feel the answer needs to be more complex. That is the challenge we are faced with as investors: To get the few, relatively simple things correct, and the most difficult part is to continue to do that over a relatively long period of time.

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