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LINNARD FINANCIAL MANAGEMENT & PLANNING, INC.

Registered Investment Advisor, Wealth Management & Financial Planning

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Outlook & Trends

Economic improvement and investment returns have been stymied so far this year. The economy officially contracted in the recent report of the first quarter results, the Dow Industrials are once again below their value at the beginning of the year, and bonds sold off. These uninspiring results could be just a slow down, or foreshadow a turning point. It is at times like these where psychology becomes an important variable in an individual investor's decisions and realized returns, so that will be our planning topic in this issue.

The Economy

The economy contracted at an annual rate of -.3% between January and March. Atlanta Fed reports better news. Their *GDPNow* real time estimate suggests we will see 2% growth in the second quarter, a positive reversal coincident with the stabilization of the dollar's recent rise versus other currencies. This is not wonderful, but it is at least consistent with the slow-growth trend that we have come to know. Both bond and mortgage interest rates climbed as Wall Street actively played their parlor game of guessing when the first Fed rate increase will occur. Inflation has totaled less than zero so far this year. Corporate profits turned positive again during the quarter, but profit growth remains below average at 4.5%. Sales of existing homes and their prices were both up compared to a year ago, and the unemployment rate continues to creep downward.

Europeans are continuing to face the problem of Greece paying its debt (or not). Greek banks have been closed by government edict to stop capital flight out of the country until a referendum is held to see if the populace will accept creditors' demands. Our understanding is that, while this recurring situation remains a problem, and could result in Greece leaving the European Union, it is not as likely to have a systemic financial effect as it might have last time. In the three years since this issue first entered the public's awareness, European banks have reduced their Greek bond exposure, and the weaker European countries like Spain and Portugal have improved their financial positions. Closer to home, Puerto Rico is also having difficulty repaying its debt. Unlike Greece, however, many Americans hold this debt through municipal bond fund investments.

The Markets

U.S. interest rates have climbed, based on a widely expected change in Federal Reserve interest rate policy that continues to be delayed by disappointing economic growth. It is not clear if this rise is an inflection point marking the end of the 30-year rate decline. It may just be a second chapter of the "Taper Tantrum" witnessed several years ago, which was sparked by the same concerns, was aggravated by the market participants' herd mentality, and eventually recovered.

Stock market bottoms are often sharp V-shaped patterns brought about by panic selling. Stock market tops are often broad, roughly horizontal patterns in which current holders who are concerned about high valuation slowly sell to the latecomers. Although the exact count is subjective, both the 2000 and 2007 tops took about 10 months to complete. During this time, the market's momentum shifts and starts falling until the entire pattern breaks down. We may have this type of pattern today. There have been other times, like 2011, however, when we almost entered a bear market after the end of the Fed's "QE2" and before their "Operation Twist" monetary support programs, where momentum slowed without engendering a large-scale reversal. So while this pattern is typical, it is not necessarily definitive.

Investment Psychology

Many years of studying the market have led us to recognize the importance of psychology on an individual's investment results. There are several aspects that seem to have the greatest impact, which you would be wise to recognize, prepare for, and protect against.

Overconfidence - Investors often consider themselves above average, just like the children in Lake Wobegon. Of course everyone cannot be above average, so if you find yourself feeling confident, be extra careful.

Anchoring - The tendency to think of a stock price in relation to your purchase price. It is at best a distraction, at worst causes paralysis. The future prospects of an investment have no relationship to the price you paid.

Loss aversion - Most people feel the discomfort of a loss much more than the pleasure of a gain. There is a tendency to ignore losses and hope that prices will recover. Avoidance of reality can cause you to get locked-in to long-term underperformance or worse.

Herd mentality - There are relatively few individual thinkers in the investment community. Stocks rise and fall based on investors hearing and passing along a story or tip from a research analyst, scammer, or another investor, creating a herd of investors all believing the same story and moving in the same direction. The public is typically at the end of the line to receive real information, after it is already fully priced into the market.

Fear - When hope of recovery dissipates and the discomfort of a loss becomes too great, fear takes over. When the herd all becomes fearful at the same time, "the baby goes out with the bathwater", and there are no more sellers, creating a bottom. The more risk you take, especially in relation to your financial circumstances, the more likely you will be adversely affected by fear.

Greed - The thought of "getting rich quick", following an appealing story and the herd can be a siren song. Overvalued markets are based on "the greater fool theory", where a person buys a stock, hoping to sell it later at a higher price to "a greater fool". On the contrary, greed is a prescription for "getting broke quick".

Self-image and Selective Memory - The self-deceiving tendency to accentuate positive results and diminish mistakes. This all too common practice keeps you from being objective and learning from experience.

These tendencies will influence your investment decisions for the worse. They are magnified when you feel stressed and pressured to make a decision. The best coping mechanism is to follow a strategy designed to minimize their influence. Many different investment strategies work. The key is to find one that will work for you. Develop one that you expect will be successful (but not too overconfident to question and improve) that you can stick with. Develop your approach in times when you can be calm, objective, and think without emotional influence. Determine what your actions will be if certain circumstances occur. When those triggers do occur, follow your strategy with discipline and without emotion. If it turns out that you made a mistake, adjust and improve your strategy for next time and move on.

Of course, another alternative is to enlist the aid of an advisor that has developed and follows a strategy that is comfortable for you. If you would like help managing your investments, looking into your financial future, or planning to manage your income effectively, please call or e-mail. We invite you to visit our website www.linnardfinancial.com.

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