Strategies

DIVERSIFIED INVESTMENT ADVISORS

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NEW YEAR, NEW YOU

Every year, people resolve to make changes for the better, some only to find that their greatest obstacle is themselves.

Behavioral economists agree. They've found that emotions and psychological quirks can cause investors to make decisions that run contrary to their own interests. Here are a few common types:

Anchoring

The tendency to base investing decisions on the first set of numbers you see. Say you buy a fund for $20 a share. If the fund's price rises, you may object to buying new shares because you're "anchored" to the lower price, even if the fund suits your needs.

Herding

Copying the behavior of other investors, spurred on by a belief that the crowd can't be wrong. This can result in buying high or selling low because everyone else is.

Loss Aversion

Making decisions motivated by the fear of a loss, such as long-term savers who hang on to a losing fund in the hope that one day it will turn around—even when there is no information to suggest this recovery will occur.

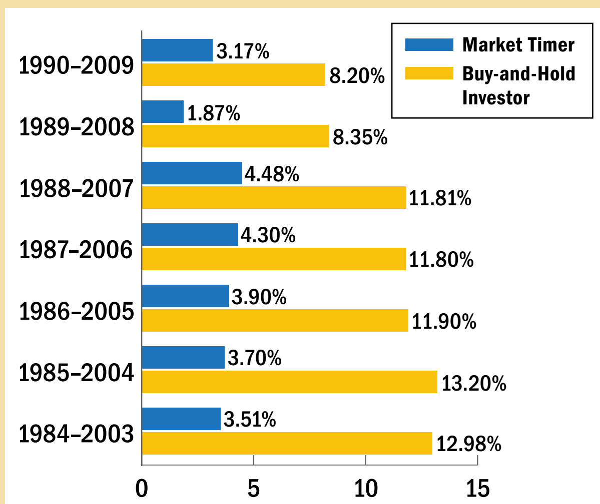
This year, don't let these mental pitfalls drag down your portfolio. Stick with an asset allocation that fits your financial goals, time horizon, and tolerance for risk. ■

Asset allocation and diversification do not assure or guarantee better performance and cannot eliminate the risk of investment losses.

Contribution Limits for 2011 This year you may contribute up to $16,500 to your retirement savings plan, $22,000 if you're age 50 or older and your plan allows.

MARKET TIMING MADNESS

Market timers, investors who try to predict the direction of the stock market, often buy high and sell low—a losing proposition. Consider the returns generated by two investors in the chart below. The market timer jumps in and out of stock funds. The buy-and-hold investor doesn't. Guess who historically earns lower returns over rolling 20-year periods?[1]



[1]Quantitative Analysis of Investor Behavior, DALBAR, Inc., March 2010.

All investments involve risk, including loss of principal and there is no guarantee of profits. Investors should carefully consider their objectives, risk tolerance, and time horizon before investing.

Winter 2011 / Vol. 16 / Issue 4

FAST FACTS

Save More Today

The 2010 Employee Benefit Research Institute (EBRI) Retirement Readiness Rating[1] shows that dramatically high percentages of Americans will likely be ill-equipped to finance their basic retirement expenses and uninsured health-care costs.

Falling short in retirement*

Early Boomers (ages 56-62)

47.2%

Late Boomers (ages 46-55)

43.7%

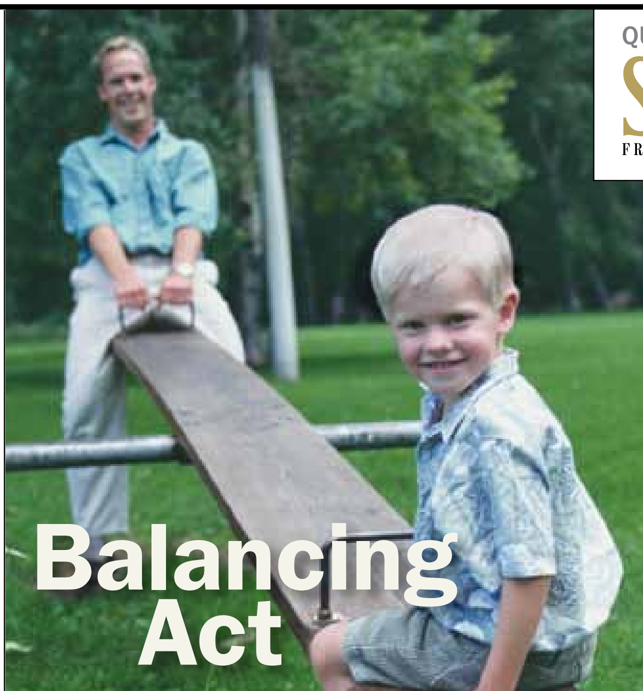
Gen X (ages 36-45)

44.5%

*Assumes a retirement age of 65

Perhaps more disconcerting is that in order to have just a 50% chance of saving enough money to last through retirement, EBRI reports that many lower-income Early Boomers already saving for retirement have to save an additional 25% or more of their salary each year from 2010 until age 65; Late Boomers: 12%; Gen Xers: 6%. While these figures may be manageable for younger savers, many pre-retirees may have to consider delaying retirement or working part-time in retirement to make their nest egg last. ■

[1] The EBRI Retirement Readiness Rating: Retirement Income Preparation and Future Prospects, Employee Benefit Research Institute, July 2010.



Balancing Act

Moving a portion of your portfolio from high-performing to low-performing investments is a way to maintain your asset allocation.

QUESTIONS & ANSWERS FROM SmartMoney FROM THE WALL STREET JOURNAL

Q Rebalancing means I'll have to transfer out of some investments that are performing well. Why would I want to do that?

A Rebalancing may seem counterintuitive. It forces you to periodically shift money from an asset that has performed well to one that has lagged. But doing so will help you maintain your asset allocation, which was constructed based on your financial goals, time frame, and tolerance for risk. What's more, when you sell some of your best-performing shares, you lock in your gains. And when you buy additional shares of an asset that has lagged, you may be getting them at a bargain price, increasing your potential return if that investment recovers. Consider recent history: Investors who conscientiously rebalanced their portfolios in 2008 moved money from high-performing bond funds into poorly performing stock funds. They were rewarded in 2009: Stocks rebounded, gaining 26%, while bonds fell -2.4%.[1]

Q Does rebalancing reduce my risk of loss?

A Yes. It keeps you from being overexposed to any single asset class. Of course, rebalancing won't insulate you from market losses, but by keeping you well diversified, it will help soften the impact on your total portfolio. Rebalancing might also save you wear and tear on your nerves because instead of trying to predict the market's ups and downs, you'll systematically adjust your portfolio every year to the long-term allocation you feel is best for you.

Q How often should I rebalance my portfolio?

A Most financial professionals recommend rebalancing once a year and/or whenever your portfolio mix has strayed by 5% to 10% from its set asset allocation. ■

[1] Morningstar, Inc., *Ibbotson® SBBI® 2010 Classic Yearbook.* Past performance is no guarantee of future results.

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