HERITAGE
PERSPECTIVE

HIG HERITAGE INVESTMENT GROUP

A QUARTERLY PUBLICATION OF HERITAGE INVESTMENT GROUP INC. SPRING 2016

Heritage Update

Discipline Works:
Discipline is important when you are navigating the capital markets. The investment process that Heritage employs is deliberately built on a solid foundation that recognizes the value of a rational, objective approach. Markets may be unpredictable, but results don't have to be.

Industry Alliances:
Fred MacLean, Jr., President of Heritage Investment Group, spoke at a recent meeting of the Estate Planning Council of Broward County. That meeting was attended by a number of local professionals and HIG portfolio manager Craig Chuang, who is a current board member.

'Tis the End of Season
We would like to extend our best wishes to all those clients who are leaving Florida for the summer. Travel safely and we look forward to your return next season.

EMPLOYEE PROFILE

Craig Chuang, CFA, CFP®, Portfolio Manager

Craig has been with Heritage for 10 years and as a Portfolio Manager, works directly with clients on all aspects of their investment and financial planning needs. Craig joined Heritage because of his conviction in the investment process the firm employs as well as the firm's emphasis on client service excellence. Craig makes his home in north Miami and is a current board member of the Estate Planning Council of Broward County. In his free time, he enjoys exploring new restaurants in the Miami area and spending time with his two young boys.

ABOUT HERITAGE

At Heritage, we have assembled a complementary team of highly qualified professionals focused on the preservation and growth of our clients' assets. We all share a love of family and the communities where we live, as well as a deep-rooted belief in the power of hard work and discipline over time. That's how we've grown our business and how we continue to guide the wealth of our clients.

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"Investing is simple, but not easy."

– WARREN BUFFETT

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Hemlines, Super Bowls, and Presidential Elections

Late-night talk show hosts and stand-up comedians love presidential election years because the non-stop political theater provides them with a constant stream of great material. Presidential election years also supply more material for stock market prognosticators, who tend to capitalize on the fact that elections imply change. Change tends to make people nervous, and this particular type of change tends to make

investors especially nervous, leading them to wonder how their investments will be impacted. This apprehension provides stock market sages with a vast, receptive audience that is ready and willing to hear their predictions about the future direction of the markets.

"In 2012, late night talk show host Jimmy Fallon's dog predicted, without hesitation, that Mitt Romney would be the next president."

Statisticians mining the data for profitable trading strategies have unearthed a wide array of factors that appear to correlate with the direction of stock markets. In the 1920's, economist George Taylor showed a correlation between the level of the stock market and the height of ladies' hemlines. Several decades later, the Super Bowl Indicator observed that the stock market had risen every year that an NFC team had won the Super Bowl, and declined whenever an AFC team won. Given the popularity of spurious statistical relationships such as these, it is unsurprising that strategists attempted to find a pattern in the seemingly logical correlation between stock prices and presidential elections.

In the 1960s, market historian Yale Hirsch proposed a market-timing strategy known as Presidential Election Cycle Theory. He claimed that US large company stocks tend to have above-average returns in an election year, while the year following the election usually sees the worst returns in the four-year presidential cycle.

Although these numbers may have held true in some time periods, the two most recent elections have called the theory into question. For example, the theory proposed that the 2008 election year should have been an above-average year for stock market returns, however, US large company stocks were down 37% that year. In 2009 (the purported weakest year in the cycle), that same group of stocks increased by 26%. The next election cycle cast further doubt on the theory, as the gains in the 2012 election year were far surpassed by the gains in the following year.

The most likely explanation of this reversal in results is that presidential elections, like hemlines and Super Bowls, have no reliable ability to predict stock market returns. Despite all of the hype, the expected profits in an election year are probably the same as in the other three years of the cycle.

But the prognostications about politics and markets will surely not end there. Even if you accept that the election cycle itself does not contain a predictable pattern, it is still fair to ask whether a presidential victory by one political party over the other suggests higher returns for stocks.

The answer to this question may surprise you. Although the Republican Party tends to be viewed as being more friendly to business and Wall Street than the Democrats, since the end of the Second World War, the returns of US stocks have been far higher under Democratic presidents (9.7% per year) than under the Republicans (6.7% per year).

However, this does not mean that a Hillary Clinton victory is a signal that you should mortgage your home and invest aggressively in the stock market. As with the presidential election cycle, the past performance of stocks under a given political party is unlikely to determine the future performance. The outperformance of stocks under Democrats provides them with a nice campaign slogan, but it is probably attributable more to chance than to economic policy.

What all of this does mean is that the outcome of the presidential election, while certainly important for the future direction of the country, is merely one of a multitude of factors that determine the results of the capital markets. The overall health of the global economy, changes in interest

rates, unpredictable global political and economic events, technological innovation, wars, weather, and any number of other factors will have more influence on the direction of the markets than will the identity (or political party) of the person in the Oval Office.

In 2012, late night talk show host Jimmy Fallon's dog predicted, without hesitation, that Mitt Romney would be the next president. That prediction was entertaining, but not particularly useful. Throughout the coming year, stock market strategists will supply you with a plethora of election-related predictions that you may find entertaining, but they will probably be no more clairvoyant than Mr. Fallon's puppy. Instead of attempting to outguess the markets, you should maintain a long-term view of your investments and leave the election commentary to the comedians.

The original version of this article was written by Heritage for the March 2016 edition of The Light, a local magazine serving Broward County, Florida.

Our Fund Selection Process

When we explain our investment philosophy, we tend to focus on "big picture" ideas such as diversification, discipline and the long-term power of capitalism. But practical implementation is also essential to the success of an investment strategy, so it is worth describing how we select the funds we typically employ.

Round One: Speculative vs. rules-based strategies
Our selection process is like a highly personalized, single-elimination tournament. We still consider the entire mutual fund universe and its thousands of possible contenders. But it is relatively easy to eliminate the vast majority of them in the early rounds, with only the strongest surviving as viable candidates.

In the first round, we want to distinguish between speculative fund managers and rules-based fund managers. We can eliminate the speculative fund managers from contention, as they are playing an entirely different game from what we have in mind.

Speculative strategists try to forecast the upcoming performance of securities, sectors or markets and trade accordingly. Speculative individuals may do this by gazing at a fund's "star" rating or acting on seemingly hot tips from any number of sources. Fund managers may hire well-heeled

analysts to probe the universe for secrets about to unfold, and issue buy, sell or hold recommendations accordingly. Either way, these are not exercises that we expect will beat the market, especially after the costs involved in trying.

Instead, a rules-based fund manager can simply hold the entire universe of securities and be part of its expected expansion. Speculative fund managers may be working very hard at what they're doing, but it's an exercise that is more likely to detract from than add to your goal of building and preserving durable wealth in volatile markets. By eliminating those who are engaging in speculative tactics from our recommended playlist, we can readily knock out a wide swath of would-be fund selections in the opening round.

Round Two: Passive vs. rules-based strategies
Once we disqualify speculative fund managers, that still leaves a relatively large (and growing) collection of funds that seek to efficiently capture various dimensions of the market's expected long-term growth without engaging in seemingly fruitless and costly forecasting.

> *"...the final step is to match the best funds with the most important factor of all: you and your individual goals."*

In this category, you'll find two broad types of funds: First, passive index funds, which track popular benchmarks such as the S&P 500 or the Barclay's Global Aggregate Bond, which in turn track particular market asset classes such as U.S. large-cap stocks or global bonds. Second, rules-based funds, which seek to wring the highest expected returns with the least expected risk out of these same asset classes in a more flexible, but still rigorously disciplined manner.

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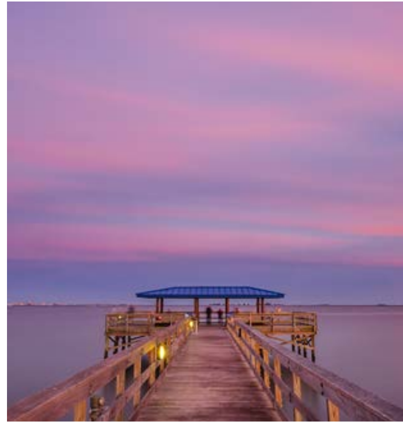

The goals of passive and rules-based strategies are similar, mind you, making it harder to choose among these second-round contestants. Each emphasizes the importance of minimizing wasted efforts and maximizing the factors we can expect to control. Still, all else being equal we typically favor rules-based funds for the core of our clients' portfolios. We feel they are structured to do an even better job at participating in relatively efficient markets over time. By being freed from slavishly following a popular index benchmark and other restrictive parameters, they can focus directly on the fund management factors that matter the most. This includes most effectively capturing markets' expected returns, while minimizing trading costs and taxes, and dampening some of the noisy volatility along the way.

Round Three: You and the rules-based strategy
Once we've narrowed down our fund choices to a manageable group, the final step is to match the best funds with the most important factor of all: you and your individual goals. This is one of many reasons why we create for our clients a personalized investment plan that addresses the appropriate level of risk to be taken, the level and timing of cash flows needed, and the strategy for minimizing taxes.

For example, investing heavily in even the best small company stock fund may be a poor choice for you if your primary goal is to preserve the wealth you already have accumulated. Conversely, an excellent conservative bond fund may not be appropriate if you are seeking aggressive growth and are willing and able to take on considerable market risk to do so.

A solid fund selection strategy
Our final round involves forming the remaining contenders into a unified team of funds that is optimized to reflect your unique goals and risk tolerances. Then, we help you maintain the discipline to stick by your carefully constructed portfolio, not just for a game or two, but over the seasons of your life.

When we talk about fund selection, we deliberately emphasize the qualities that decades of empirical and practical evidence have indicated are worth pursuing over time, and we explicitly downplay the more reactionary antics found in the financial media. Celebrity fund managers – with their glittery victories and agonizing defeats – may be interesting to read about, but we believe that the best investment selections are the ones that help you achieve your own hopes and dreams by keeping your financial footing on a solid, rules-based ground.

In accordance with rule 204-3(c) of the Investment Advisors Act of 1940, Heritage Investment Group, Inc., hereby offers to deliver without charge, a copy of its brochure (ADV Part 2) upon request. In addition, upon request, Heritage will deliver, without charge, a copy of its corporate Code of Ethics.

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Heritage Investment Group would like to thank all of our clients for their continued support. We are here to help you plan for your future. If you have any family members or friends who might benefit from our help, we would welcome the opportunity to speak with them. Please contact us at 954-785-5400.

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