HERITAGE
PERSPECTIVE

CELEBRATING 25 YEARS

HIG HERITAGE INVESTMENT GROUP

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Heritage Update

CONSISTENCY HITS A HOME RUN

The lazy days of summer are upon us and that means time to enjoy America's favorite pastime. Baseball has the longest season of any sport with 162 games and consistency throughout the long season is the key to a shot at the pennant and a World Series ring. At Heritage, it has always been our philosophy that consistency is key; a consistent investment process with a long-term focus is the foundation of a winning investment strategy.

WEALTH MANAGEMENT IS A TEAM SPORT

Some teams are built around star players, but the most successful organizations are those that emphasize teamwork and cooperation. At Heritage, we have talent in every area of our firm, and our commitment to serve our clients with an unselfish team approach has helped us to successfully grow our business for over 25 years.

IT'S A TRIPLE PLAY

For the third time, Heritage Investment Group is pleased to announce it has been named to the 2018 edition of the Financial Times Top 300 Registered Investment Advisors. The list recognizes top independent RIA firms from across the US.

EMPLOYEE PROFILE

Timothy G. Slattery, PhD

Tim Slattery is a partner at Heritage and as the firm's Chief Investment Officer he has led our Tampa office since 2002. Tim's work at Heritage is driven by his passion for investment theory and his commitment to his clients, which spans 22 years in the investment business. In addition to his background in academic finance, Tim also has a PhD in philosophy, and he periodically serves as a part-time adjunct professor of philosophy, most recently at the University of Tampa. Tim's other passions include travel, college football, and spending time with his wife and two young children.

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.

Inside this Issue

"The way a team plays as a whole determines its success."

– BABE RUTH

Investors Behaving Badly

"It has been said that man is a rational animal. All my life I have been searching for evidence which could support this."

– BERTRAND RUSSELL

One of the key assumptions of classical economic theory is that individuals behave rationally and act in their own economic self-interest. It is presumed that we all make economic decisions based solely on an objective view of relevant data, an accurate understanding of how predictable the world is, and an honest assessment of our own values and abilities.

In a world full of casinos, Ponzi schemes, and $1,000 sneakers, it is easy to see that the assumption of economic rationality is not an accurate depiction of the way humans actually behave. But what causes individuals to consistently make decisions that are not in their own economic self-interest? Recent research in the field of behavioral economics has uncovered several identifiable psychological biases that help explain these irrational tendencies.

Overconfidence

Overconfidence is probably the most common of the behavioral biases, and it is the easiest to understand because we recognize it in those around us every day (even though we usually fail to recognize it in ourselves). Overconfidence runs rampant especially in American men, who tend to believe, without any formal training, that they are experts in geopolitical strategy, fantasy football, and stock picking.

"The human psychological constitution almost always drives investors to overestimate their investing ability..."

Overconfidence leads many investors to believe that they can outsmart the stock market by timing the ups and downs of the market or by picking stocks to outperform the market, despite numerous past failures and overwhelming academic evidence that these practices are almost always counter-productive. As economist Ken French has said, "Overconfidence is almost certainly the most important bias in behavioral finance. But most people still think I'm not talking about them."

Activity Bias

Activity bias is the human tendency to feel like we should be doing something rather than doing nothing, even if being active is unhelpful, or harmful. It often occurs in stressful situations or when others around us are active as well. When you are caught in stop-and-go traffic and you are incessantly changing lanes only to find that the lane you just exited is flowing quickly now, you are experiencing activity bias firsthand.

In a stock market context, activity bias is harmful because it drives investors to trade too frequently and to feel stressed if they are inactive when markets are either skyrocketing or sharply declining. Studies have shown that investors who trade less frequently tend to outperform those who trade more often, but activity bias makes disciplined investing less likely.

During the dot.com boom of the late 1990's and the real estate boom in the 2000's, investors saw others around them getting rich and activity bias drove them to buy expensive stocks without considering the price being paid. During the busts that followed these booms, activity bias led some investors to sell stocks when they saw others around them panicking, thereby locking-in losses just before stocks began to rise once again.

Self-attribution Bias

Self-attribution bias is the tendency to attribute our successes to our own talents or hard work, and to attribute our failures to unforeseeable external forces beyond our control. This bias is prevalent in sports gamblers, who often attribute their wins to astute analysis while their losses are simply due to bad luck.

Self-attribution arises out of our need for self-esteem, and while it is a separate bias in its own right, it also leads to overconfidence. The investing world is full of amateurs as well as professionals who are convinced that their stock-picking strategy would have been a huge winner were it not for an incredible run of bad luck that no one could have seen coming. Despite abundant historical evidence to the contrary, they remain confident that with just a couple of minor tweaks it will be successful next time.

Recency Bias

Recency bias, also known as extrapolation, is the tendency to project the recent past into the future. Insurance agents are quite familiar with this. Every time a natural disaster strikes, applications for new insurance policies spike immediately after the disaster, as homeowners imagine more catastrophic events are on the way. Then, the applications gradually taper off as the memory of the event fades, only to spike again after the next disaster occurs.

Investors exhibit recency bias by extrapolating past trends in the stock market into the immediate future. There is a strong tendency for investors as a group to be most optimistic after a recent string of increases in stock prices, and to be most pessimistic after the market has experienced a large pullback. This tendency to feel bold after a good result and fearful after a poor result is certainly understandable from a psychological perspective, but a rational investor should be a more willing buyer after prices have fallen, and vice-versa.

Forewarned is Forearmed

These irrational biases have served humans well from an evolutionary standpoint, and they aid us in many areas of our everyday lives. Overconfidence is helpful for entrepreneurs and politicians, activity bias encourages goal-directed behavior, self-attribution bias protects our often-fragile self-esteem, and recency bias reminded our ancestors to stay away from the tall grass because the last guy that went over there got eaten by a tiger.

Unfortunately, these biases are not well-suited to investing. The human psychological constitution almost always drives investors to overestimate their investing ability and to trade too frequently and often in the wrong direction. Worse yet, these biases cannot be eliminated; they are a part of our most basic human nature.

However, it is possible to construct a financial plan and an investment strategy that account for these tendencies. Recognizing their existence allows you to make sure that your advisor also understands how these biases impact your financial thinking, and his or her own. We may never be able to eliminate bad investment behavior, but we can use our understanding of it to ensure a successful financial future.

The original version of this article was written by Heritage for the November 2017 edition of The Light, a local magazine serving Broward County, Florida.

Charitable Giving and the Donor-Advised Fund

No matter how the 2017 Tax Cuts and Jobs Act (TCJA) may alter your tax planning, we would like to believe one thing will remain the same: With or without a tax write-off, many Americans will still want to give generously to the charities of their choice. After all, financial incentives are not usually the main motivation for giving. We give to support the causes we cherish. We give because we are grateful for the good fortune we have enjoyed. We give because it elevates us too. Good giving feels great – for donor and recipient alike.

That said, a tax break can feel good too, and it may help you give more than you otherwise could. Enter the donor-advised fund (DAF) as a potential tool for continuing to give in a meaningful and tax-efficient way under the new tax law.

What Has Changed about Charitable Giving?

To be clear, the TCJA has not eliminated the charitable deduction. You can still take it when you itemize your deductions. But the law has limited or eliminated several other itemized deductions, and it has roughly doubled the standard deduction (now $12,000 for single and $24,000 for joint filers). With these changes, there will be far fewer scenarios in which it will make sense to itemize deductions instead of just taking the now-higher standard allowance.

This introduces a new incentive to consider batching-up your deductible expenses, so they can periodically "count" toward reducing your taxes due – at least in the years you have enough itemized deductions to exceed your standard deduction. For example, if you usually donate $2,500 annually to charity, you could instead donate $25,000 once each decade. Combined with other deductibles, you might then be able to take a nice tax write-off for that tax year and take the standard deduction in the other years.

What Can a DAF Do for You?

Donor-advised funds (DAFs) are not new; they have been around since the 1930s. But they have been garnering more attention as a potentially appropriate tax-planning tool under the TCJA. Here is how they work:

1. **Make a sizeable donation to a DAF.** Donating to a DAF, which acts like a "charitable bank," is one way to batch up your deductions for tax-wise giving. But remember: DAF contributions are irrevocable. You cannot change your mind and later reclaim the funds.
2. **Deduct the full amount in the year you fund the DAF.** DAFs are established by nonprofit sponsoring organizations, so your entire contribution is available for the maximum allowable deduction in the year you make it. Plus, once you have funded a DAF, the sponsor typically invests the assets, and any returns they earn are tax-free. This can give your initial donation more giving-power over time.
3. **Participate in granting DAF assets to your charities of choice.** Over time, and as the name "donor-advised fund" suggests, you get to advise the DAF's sponsoring organization on when to grant assets, and where those grants will go.

Thus, donating through a DAF may be preferred if you want to make a relatively sizeable donation for tax-planning or other purposes, you would like to retain a say over what happens next to those assets, and you are not yet ready to allocate all the money to your favorite causes. Along the spectrum of charitable giving choices, a DAF is relatively easy and affordable to establish, while still offering some of the benefits of other planned giving vehicles. As such, they fall somewhere between simply writing a check to the charity, versus taking on the time, costs and complexities of a charitable remainder trust, charitable lead trust, or private foundation.

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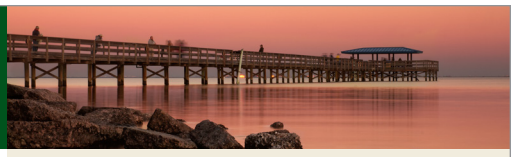

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How Do You Differentiate DAFs?
If you decide a DAF would be useful to you, the next step is to select an organization that sponsors a DAF. Sponsors typically fall into three categories: financial providers (such as brokerage firms), independent DAF organizations (American Endowment Foundation is one), and "single issue" entities (such as religious, educational, or emergency aid organizations).

Within and among these categories, DAFs are not entirely interchangeable. Whether you are being guided by a professional advisor or you are managing the selection process on your own, it is worth doing some due diligence before you fund a DAF. Here are some key considerations:

Minimums – Different DAFs have different minimums for opening an account. For example, one sponsor may require $5,000 to get started, while another may have a higher threshold.

Fees – As with any investment account, expect administration fees. Just make sure they are fair and transparent, so they do not eat up all the benefits of having a DAF.

"With or without a tax write-off, many Americans will still want to give generously to the charities of their choice."

Acceptable Assets – Most DAFs will let you donate cash as well as stocks. Some may also accept other types of assets, such as real estate, private equity or insurance.

Grant-Giving Policies – Some grant-giving policies are more flexible than others. For example, single-entity organizations may require that a percentage of your grants go to their cause, or only to local or certain kinds of causes. Some may be more specific than others on the minimum size and/or maximum frequency of your grant requests. Some have simplified the grant-making process through online automation; others have not.

Investment Policies – As touched on above, your DAF assets are typically invested in the market, so they can grow tax-free over time. But some investments are far more advisable than others for building long-term giving power. How much say will you have on investment selections? If you're already working with an advisor, it can make good sense to choose a DAF that lets your advisor manage these account assets in a prudent, fiduciary manner, according to an evidence-based investment strategy.

Transfer and Liquidation Policies – What happens to your DAF account when you die? Some sponsors allow you to name successors if you would like to continue the account in perpetuity. Some allow you to name charitable organizations as beneficiaries. Some have a formula for distributing assets to past grant recipients. Some will roll the assets into their own endowment. Also, what if you decide you would like to transfer your DAF to a different sponsoring organization during your lifetime? Find out if the organization you have in mind permits it.

Selecting an ideal DAF sponsor for your tax planning and charitable intent usually involves a process of elimination. To narrow the field, decide which DAF features matter the most to you, and which ones may be deal breakers. Your advisor can help you make a final selection and meld it into your greater personal and financial goals.

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Heritage Investment Group is pleased to celebrate 25 years helping people plan their financial futures and we would like to thank all of our clients for their continued support. Helping people navigate financial markets and secure their investment goals is paramount to our firm. If you have any friends or other family members who might benefit from our expertise, we would welcome the opportunity to speak with them, and can be reached at 954-785-5400.

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