HERITAGE PERSPECTIVE

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SPRING 2020

Heritage Update

STAYING THE COURSE

We are in an unprecedented time in history and the markets have reacted with extraordinary volatility. And while the circumstances driving the markets are different than in the past, one thing remains the same; investors would be wise to stay the course. At Heritage, our philosophy has always been to manage through all market cycles by establishing and maintaining a diversified, well-structured portfolio. Today is no different; a disciplined, unemotional approach to investing makes the most sense.

WE ARE HERE TO HELP

Social distancing has perhaps become our "norm," and it is this idea of staying away from one another that is at odds with our natural human tendency to want to connect. Fortunately, technology has allowed us to stay connected in a myriad of ways. As always, our clients remain our priority and we are available to you via phone, e-mail, and videoconference whenever you need us.

SPRING IS HERE

Spring is typically a time that affords a chance to shake off the dust of winter and assess your plans for the year. Part of that planning should be a review of your financial plan. Making sure that your plan is properly structured to meet your long term goals means that you can move ahead with confidence and peace of mind.

EMPLOYEE PROFILE

Frederick R. MacLean, Jr., CFA, MBA, CFP® – President

Fred co-founded the firm over 25 years ago along with his parents, Fred and Sherry MacLean. Heritage was built on a solid investment process with a singular focus on real results, superior client service, and a commitment to the highest standard of ethics. That focus and commitment is very much part of the Heritage story today, as is a commitment to our local community. Fred and his family are very active in the Lighthouse Point community where Fred serves on a number of local boards and charitable organizations. As Heritage looks ahead to the next 25 years, the focus remains on helping people plan for their future.

ABOUT HERITAGE

Successful long-term investing rarely depends on stock picking or market timing. That's why we scientifically engineer portfolios to harness the power of thousands of stocks and bonds from around the world, and why we guide our clients with the understanding that market volatility is inevitable. Above all, we believe that success is in the implementation. We do what we say, in your best interest, consistently, and without emotional reaction.

Inside this Issue

"Our most significant opportunities will be found in times of greatest difficulty."

– THOMAS S. MONSON

A Question of Equilibrium

"Sellers were out in force on the market today after negative news on the economy." It's a common line in TV finance reports. But have you ever wondered who is buying if so many people are selling?

The notion that sellers can outnumber buyers on down days does not make sense. What the newscasters should say, of course, is that prices adjusted lower because would-be buyers were not prepared to pay the former price. What happens in such a case is either the would-be sellers sit on their shares or prices quickly adjust to the point where supply and demand come into balance and transactions occur at a price that both buyers and sellers find mutually beneficial. Economists refer to this as equilibrium.

But the price at which equilibrium is reached can change. That is because new information is coming into the marketplace continually, forcing would-be sellers and would-be buyers to constantly adjust their expectations.

That new information might be company-specific news on earnings. It might be news that has implications for specific industries—like a fall in oil prices. Or it might be an economic development that affects the entire market, like a change in the progression of the coronavirus pandemic. Given this constant flux in the flow of news and information and the changing expectations of participants, it can be reassuring to remember that for everyone selling shares there must also be buyers of those shares or the trade will never take place. And whenever information changes, prices may change and quickly reach a new level of equilibrium.

"Competition among buyers and sellers is such that it's not possible to consistently outguess the market."

Given that security prices rise and fall based on a multiplicity of influences, how should investors interpret and act on these signals? We believe that trying to untangle all these influences and profit from perceived mispricing is not possible in a systematic and scalable manner. An alternative approach is to start by accepting that prices are fair and reflect the collective expectations of market

participants. While information frequently changes, this is quickly built into prices. Competition among buyers and sellers is such that it's not possible to consistently outguess the market.

The second step is to see that fairly priced securities can have different expected returns. And we can use market prices and security characteristics to identify those securities that offer higher expected returns.

The third step is to build highly diversified portfolios around these broad drivers of return, while implementing efficiently and managing the cost of buying and selling securities.

The final step is to apply discipline and rebalance your portfolio to either stay within your chosen risk parameters or to adjust for changes in circumstances.

Ultimately, the market is like a giant information processing machine. All the influences mentioned above are constantly being assessed by millions of participants, and prices adjust based on those collective expectations.

The returns we expect from investing do not necessarily show up every day, every week, every month, or even every year. But the longer we stay invested, the more likely we are to capture them. So, rest assured that even when prices are falling, people are still buying. The market is doing its job, and we believe the rewards will be there if you remain disciplined.

Career Day

"If you can't explain it to a six year old, you don't understand it yourself." - ATTRIBUTED TO ALBERT EINSTEIN

Last year one of our partners was asked to give a career day presentation to his son's elementary school class. He enthusiastically accepted, but soon began to have some concern with the challenge of explaining to a group of children just exactly how stock and bond investing works and why these investments are important to everyday people in every developed economy on Earth. Concern quickly turned to terror as he imagined having to present the story of his career in wealth management after the class had already heard from a judge, a doctor, a veterinarian, and most formidable, a fireman in uniform.

Although this career day story has a happy ending, it underscores the fact that explaining the true nature of capital markets can be difficult. And, it is difficult not simply because the topic is complex, but because capital markets are such a fixture of contemporary American life that they are often taken for granted by amateur and professional investors alike, and their core purpose is often misunderstood or overlooked entirely.

Take the stock market as an example. It might be easy to explain what a stock is, but it is a bit more involved to understand *why* the stock market exists in the first place. Think about it: Most companies begin their lives as "private" corporations. They are owned entirely by the founders and original investors of the company and all of the company profits are retained by those few individuals. Eventually some corporations, usually the most successful ones, reach a point where they have opportunities for growth that are too large to be financed by the original owners; those companies will "go public" by selling a portion of the founders' ownership to strangers in exchange for cash to fund the company's growth ambitions. Those strangers (now known as shareholders) then have the option to retain their ownership interest in the company or sell it to another investor at a mutually agreed price. These secondary buy and sell transactions make up the stock market. Although this is the essential reason for the existence of the stock market, it is unlikely that this explanation would make it into an elementary school career day presentation.

What about the bond market? You probably know that when you buy a bond you receive a series of interest payments and, at a predetermined future maturity date, your original investment principal is returned to you. But have you ever stopped to consider that when you buy a bond what you are actually doing is making a loan? Whether you give your cash to a corporation, a municipality, or the US Treasury, you are essentially acting as a bank, lending money for an interest payment with a promise of future return of your principal. And, the billions of dollars in bonds that change hands on the global bond markets each day are merely loans that are being bought and sold by various lenders with different income needs and risk appetites.

These mundane explanations of stock and bond markets provide a very different impression from the flashing lights, ringing bells, and screaming traders that are depicted by the financial media. And although the lights and bells of the trading floor would make for a more engaging presentation on career day, the mundane version represents the true nature of the markets.

We have this market infrastructure for a reason, and the reason is not to provide a casino for hedge funds and computerized trading programs to gamble with each other (although that has been a side effect). This market infrastructure exists because it serves as the grease in the wheels of capitalism. It identifies corporations that need capital for growth and governments that

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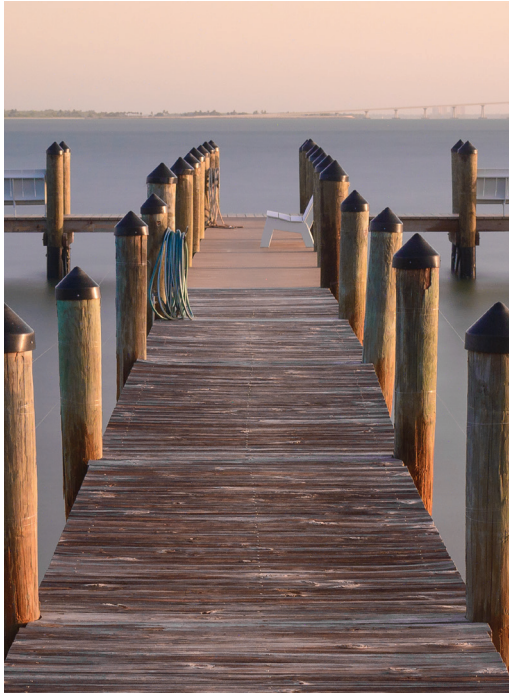
need to finance spending, and it matches them with investors who can supply that capital. Those suppliers of capital demand a financial return for their investment, and this return is a source of wealth enhancement for millions of large and small investors around the world.



Any individual who owns a bond, a share of stock, or a mutual fund benefits from the capital market system. Any retiree who is receiving payments from a company pension plan also benefits. Employees who are covered by a 401(k) plan at work and aspiring college students who have 529 college savings plans benefit from capital markets as well. Although this diverse group of beneficiaries may not always realize it, their savings are providing capital to finance today's production and tomorrow's technological innovations.

"It might be easy to explain what a stock is, but it is a bit more involved to understand why the stock market exists in the first place.

Stock and bond markets are an essential element of contemporary life as we know it, and although our industry is full of impressive jargon, perhaps we can take a lesson from elementary school and recognize that a simpler, more fundamental understanding of capital markets would be more useful to most people. That said, no matter how fundamental we make it, we will never be able to compete with the fireman on career day.

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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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