Heritage Perspective

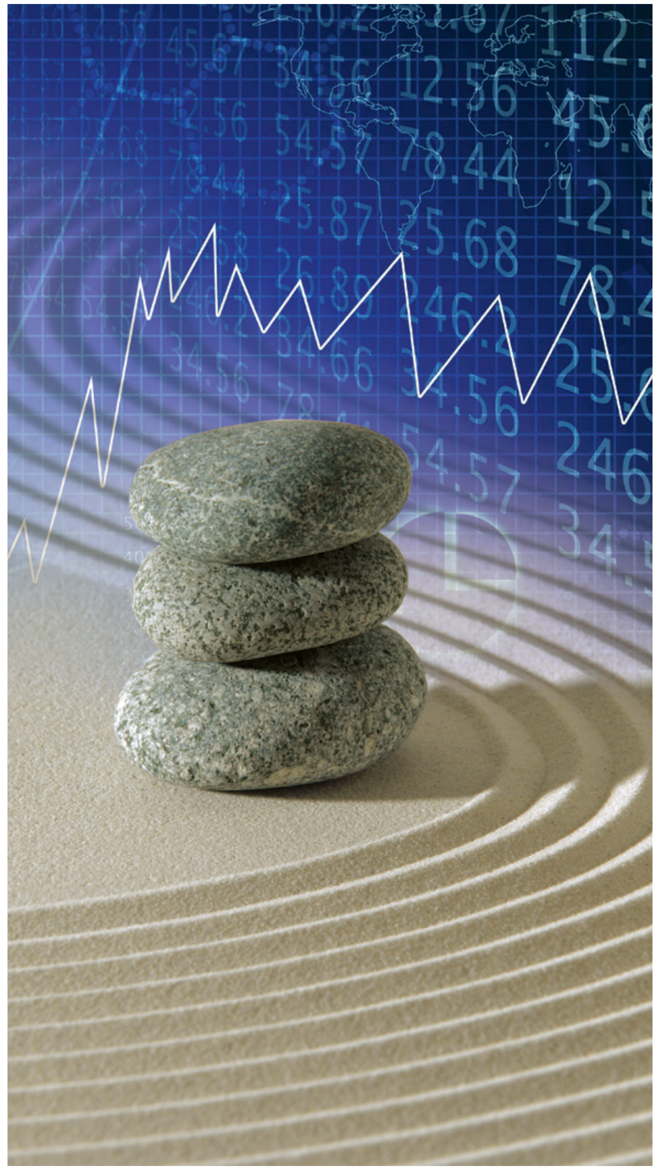
Second Quarter - 2014

A Quarterly Publication for the Clients of Heritage Investment Group, Inc.

Simplicity and Sophistication

The Chinese philosopher Confucius once said that life is very simple, but we insist on making it complicated. You could say the same thing about investing.

> *"...there is an incentive for many players in the financial services industry and media to make investing seem complicated."*



Complexity in investing often comes with a lack of transparency. The highly engineered and multilayered financial derivatives that contributed to the global financial crisis five years ago are a case in point. For many investors, these products were problematic because their complexity was such that it was very difficult to understand how they were designed, how they were priced, and whether the proposed payoffs were right for the investors' own needs.

Of course, there is an incentive for many players in the financial services industry and media to make investing seem complicated. For some investment banks, for instance, complexity provided a cover for overpricing.

In contrast, there are far fewer mysteries about the underlying stocks and bonds traded each day in public capital markets, where prices are constantly in flux due to news and the ebb and flow of supply and demand. The virtue of these highly competitive markets for most investors is that prices quickly incorporate new data and provide rich information on risk and return. From these millions of securities, diverse portfolios can be built according to the appetites and needs of each individual investor.

continued on next page

Heritage Investment Group would like to thank all of our clients for their continued support. If you have any friends or family members who could benefit from our disciplined investment process, we would welcome the opportunity to speak with them. Please contact us at (954)785-5400.

Heritage Investment Group
www.heritageinvestment.com

2480 N.E. 23rd Street
Pompano Beach, FL 33062
Phone: 954.785.5400
Fax: 954.933.0966

115 South Fielding Avenue
Tampa, FL 33606
Phone: 813.258.1759
Fax: 813.254.3756

1540 International Pkwy., Ste. 2000
Lake Mary, FL 32746
Phone: 407.536.5370
Fax: 407.536.5301

continued from previous page

The competitive nature of public capital markets, the efficiency of pricing, and the difficulty of getting an edge are what underpin the "efficient markets hypothesis" of Professor Eugene Fama, who was awarded the Nobel Prize in economics in 2013. The practical takeaway from Fama's work is that you are better off letting the market work for you rather than beating yourself up adopting complex, expensive, and ultimately futile strategies to "outperform" the market.

"The practical takeaway from Fama's work is that you are better off letting the market work for you ..."

Writing in the Financial Times on October 14, 2013, economist and columnist Tim Harford said Fama had helped millions of people by showing them the futility of picking stocks or timing the market. "If more investors had taken efficient market theory seriously, they would have been highly suspicious of subprime assets that were somehow rated as very safe yet yielded high returns," Harford wrote.

The idea of efficient markets might be counter-intuitive to many people. After all, in other areas of our lives, like business, the secret to success is to study hard, compete aggressively, and constantly look for an edge over our competitors. But Fama's research has shown that financial markets do not work in this way.

The simpler approach is to adhere to three core principles: Markets reflect the aggregate expectations of investors about risk and return, diversification helps reduce uncertainty, and proper portfolio structure can add value. For the individual investor, the essential add-ons to this are staying disciplined and keeping a lid on fees and costs.

Yes, these are simple ideas, but to paraphrase another philosopher (Leonardo da Vinci), *simplicity is the ultimate sophistication.*

There Is Life after Death, at Least in Your Investment Portfolio

"I don't want to achieve immortality through my work; I want to achieve immortality through not dying. I don't want to live on in the hearts of my countrymen, I want to live on in my apartment."

– Woody Allen

Death is a topic that most of us like to avoid, for obvious reasons. However, despite the level of discomfort most of us have about the subject, it is likely that you have done something to prepare for it. On the financial side of things, this preparation typically begins with drafting a simple will to specify to whom your financial assets should be given upon your death. Your estate plan may even include trusts or more complex planning to optimize the distribution of those assets. Yet, even if you have a solid estate plan, if you lack an investment plan to go with it, your legacy could be mismanaged and easily squandered. Wealthy individuals all too often spend considerable effort in thinking about who should receive their financial assets and when they will have access to those assets, but not about how the assets are to be managed.

Many successful investors fail to consider this aspect of planning because they have never felt the need for expert investment help in the past. However, while you may have considerable investment experience and knowledge, or you may work with a trusted financial advisor, your spouse and heirs may not have the same level of comfort, knowledge or expertise. In the event of your death, your wills and trusts will ensure that your assets are distributed to the appropriate individuals and organizations at the appropriate time, but without a written investment plan there is no way to guarantee that your assets will be invested in an appropriate manner.

Fortunately, a proper investment plan can be put into place via some relatively simple planning techniques. You have several options:

- Let it ride: If all of your heirs are competent and confident in managing their own investments, or if they have selected advisors that you are comfortable with, the management of your assets after you are gone may not be a problem. Very few individuals are fortunate enough to be in this situation.

- Draw a treasure map: Some individuals elect to give their heirs written instructions regarding investment management. The problem with this approach is that your heirs are not required to follow your instructions, and even if they attempt to do so, no set of instructions is flexible enough to account for every possible contingency in a constantly-evolving investment landscape.

- Build a fortress: The most reliable solution is to retain a trusted investment advisory firm and designate that firm as the manager of your assets after your death. In order to ensure the responsible management of the assets, you should choose a fee-only registered investment advisor who, like your attorney or accountant, has a fiduciary obligation to act in your best interest and in the best interest of your beneficiaries.

Designating a fiduciary investment advisor has many benefits. First, the advisor can help you draft a detailed investment policy statement so there will be no arguments among your heirs regarding how you would have wanted the assets to be invested. Avoiding arguments is the primary motivation for stipulating specific items in your estate planning documents. So why not do the same with investments? Second, designating an advisor prior to your death can remove a potentially stressful burden from the shoulders of your heirs. The weeks and months following the death of a loved one are difficult enough without the added difficulty of searching for a trusted advisor or attempting to manage an investment portfolio on behalf of the entire family. Third, designating an advisor now will allow you to connect the present with the future. If your family is already familiar with their future advisor, and the advisor has firsthand knowledge of your goals, the future implementation of your investment plan will be far more successful.

Death is an uncomfortable subject, and we can all agree with Woody Allen that it is preferable to live on in the comfort of our homes. The good news is, we can live on in the hearts of our countrymen, and more importantly, in the hearts of our families. Your own financial legacy can live on for many years if you are able to provide specific guidance to your heirs regarding its proper management. Even intelligent, hard-working and well-meaning heirs can bring a family legacy to ruin if they lack the knowledge and expertise to properly manage the assets entrusted to them. Making an investment plan part of your estate plan and, in particular, retaining a fiduciary expert to manage your investments after you are gone, will increase the likelihood that all of your goals are met.

Helping your family to prepare for life after you are gone allows all of you to enjoy life while you are still here. As Mae West so aptly put it, "You only live once, but if you do it right, once is enough."

This article was originally written by Heritage for the March 2014 edition of The Light, a local magazine serving Broward County, Florida.

The Golden Ticket Trap

In a popular children's story, the young hero pins all his hopes on finding one of a handful of "golden tickets" hidden among millions of candy bars. It seems many people approach investing the same way.

The notion that the path to long-term wealth lies in locating secret and previously undiscovered treasures in the global marketplace of securities is one regularly featured in media and market commentary. The Daily Mail, for instance, runs a feature called "Fund Managers' Secret Stocks," referring to supposedly "bargain" stocks the pros keep hidden. (How the stocks can be secret when splashed on magazine stands nationally is not explained.) Likewise, a popular business broadcaster regularly tells its viewers about the "under-the-radar" stocks that Wall Street analysts don't want them to know about.

"Taking big bets on a single sector or commodity is a bit like buying a chocolate bar in the hope of finding a golden ticket."

This stuff sells because it plays to a misconception about how markets work: that they are like beaches after a hot day, full of buried treasures. All you need, in this view of investing, is a virtual metal detector to find the money that people left behind.

You could get lucky this way, of course. But basing a long-term investment strategy on stumbling across the equivalent of a mislaid trinket in the sand or a golden ticket in a chocolate wrapper is not likely to be sustainable. It's a haphazard approach, reliant on chance and requiring a lot of work that is unlikely to be rewarded. Worse, it means taking unnecessary risks by tying one's fortunes to a handful of securities or to one or two sectors.

Taking big bets on a single sector or commodity is a bit like buying a chocolate bar in the hope of finding a golden ticket. There's an element of pot luck, and you're exposing yourself to idiosyncratic risk related to that sector or industry.

On the subject of hidden treasures, gold itself can have a special allure for investors, particularly in uncertain times. Indeed, the yellow metal has had a couple of spectacular runs, in the 1970s and in the 2000s. But there have been long lean times and significant volatility in between, which makes gold a highly speculative bet.

In early 2013, the Daily Mail in the UK carried the headline, "Gold Set to Shine Even More Brightly in 2013." The rationale was that with investors scouring the world for "safe havens," gold could reach as high as $2,500 an ounce by year end. As it turned out, gold suffered its biggest annual loss in three decades last year, with its spot price falling 28% in US dollar terms. From an all-time high of $1,920 in September 2011, gold fell to just over $1,200 by the end of 2013.

The popularity of media stories about hidden bargains and undiscovered stocks is understandable. Like townsfolk in a bar overhearing the boasting of gold diggers down from the hills, we desperately want to believe in El Dorado. But this sort of speculation is really no different than gambling.

In contrast, sound investment starts with identifying the risks worth taking and minimizing the risks that do not come with an expected reward, like taking a big bet on gold. You can help reduce risk and increase flexibility by diversifying.

It is true that you can get lucky the other way, like the boy in the chocolate factory story. But the odds are definitely against you. And keep this in mind: The best investment may not be the golden ticket anyway.

H|I|G HERITAGE INVESTMENT GROUP