HERITAGE PERSPECTIVE

FOURTH QUARTER – 2012

A QUARTERLY PUBLICATION FOR THE CLIENTS OF HERITAGE INVESTMENT GROUP, INC.

Investors Not Having 'Fun' Anymore: They Miss the Point

A recent survey by the research firm Spectrem Group found that well-to-do investors say investing is not as much fun as it was a few years ago. Only a third of investors with $1 million or less to invest said they enjoy investing these days. About 43 percent with $1 million to $5 million say investing is enjoyable, while 52 percent with $5 million to $25 million are having fun. In a survey a few years ago about two-thirds of wealthy investors said they enjoyed investing.

Fatigue factor

Spectrem's director of business development said "investor fatigue" from recent market volatility plus concerns about personal finances may be the cause of the bad feelings. "Investors have almost become tired of the constant worry that comes from being so involved, and many just can't seem to find strategies that they're happy with," said Randy Wostratzky.

"...investing should be more like watching paint dry or watching grass grow. If you want excitement, take $800 and go to Las Vegas."

It is undeniable that markets have been volatile since the 2008 financial crisis, but are investors missing the point? Is investing supposed to be "fun?" It is apparent that some of these investors are confusing investing with speculation.

It can be fun to buy a hot stock and reap a quick, large profit, just as it is fun to hit a slot machine for a big payoff. But that is not investing; it is short term speculation. And, just as in Las Vegas, it is as easy to lose money speculating on stocks as it is to win.

Get used to boring

Investing, on the other hand, is a long-term process of constructing a well-balanced portfolio and leaving it alone to grow as markets move ahead. It may take many years of ups and downs before a portfolio even shows a profit. But an investor who is patient, maintains a diversified exposure to markets, and keeps adding to his portfolio during his working lifetime usually comes out ahead. As Nobel-prize-winning economist Paul Samuelson once said, "investing should be more like watching paint dry or watching grass grow. If you want excitement, take $800 and go to Las Vegas."

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

Investors Sitting on Large Amounts of Cash at the Wrong Time

The consumer inflation rate has been approximately 2% for most of this year. This may sound fairly benign, but it is not if you are keeping large sums of money in the bank at today's interest rates.

As any saver knows, interest rates on bank deposits, money market mutual funds, and short-term U.S. Treasury Bills are miserable, hovering close to zero. And the Federal Reserve Board, which manipulates short-term interest rates in order to achieve its dual mandate of low inflation and full employment, has vowed to keep rates at current levels into the year 2015.

> *"The average investor has 26 percent of her portfolio in cash because she is scared to invest in a volatile market environment."*

But scared investors are sitting on a ton of cash, even as they worry about the threat of inflation, according to a survey done for MFS Investment Management. The average investor has 26 percent of her portfolio in cash because she is scared to invest in a volatile market environment. The cost of that perceived safety is a decline in purchasing power; as each day passes and inflation rises, money held at the bank will purchase fewer goods and services. Although everyone should keep a small cash store in a safe place for emergencies, it is detrimental to your wealth to hold excess cash these days.

Savers have two good alternatives. One is to use some of the excess cash to pay down debt. Almost any loan today, from a mortgage to a credit card balance, is charging more interest than you are making at the bank.

The second alternative is to invest some of the cash into a diversified portfolio that includes stocks and bonds. Yes, you will have to deal with market volatility, but higher rates on bonds and capital appreciation on stocks will give you a fighting chance to beat inflation.

Scary Predictions by Perma-bears Are Just Hot Air

Volatile stock markets generate a peculiar type of celebrity known as the "perma-bear." This is the highly negative forecaster who gets credited with calling a bear market before it starts. What you are usually not told by the financial media is that he or she has been calling for a bear market for years without success. When their big chance finally comes, perma-bears milk it for all it is worth, selling books, newsletters, and speaking tours, and getting on television every time the market moves down.

Roubini's warnings

The latest famous soothsayer is Nouriel Roubini, who teaches at New York University and operates Roubini Global Economics. He began calling for a collapse of the housing market and subsequent recession in 2005; three years later he was vindicated by the 2008 financial crisis and bear market. Roubini, who is now sought out by governments and investors worldwide, remains bearish and has earned the nickname Dr. Doom. The problem with being a perma-bear is that you will only be right about a third of the time. In the past, stock markets and the world economy have been in expansion the other two-thirds of the time.

Ruff times

One of Roubini's predecessors in the perma-bear role was Howard Ruff, a famous financial advisor and hard money advocate in the 1970s. He wrote a bestseller, "How to Prosper During the Coming Bad Years," in 1979, just a few years before the greatest bull stock market of the century began.

> *"When their big chance finally comes, perma-bears milk it for all it is worth..."*

Ruff was a critic of stocks and advocated owning precious metals, art, and coins. He lost favor after gold peaked in a speculative bubble in 1980. In February 2009 he was at it again, predicting stocks would crash. Shortly after he made his prediction, a new bull market began, leading to a doubling of stock prices.

Joe Granville

A contemporary of Ruff's, Granville achieved huge popularity in the 1980s by claiming to use his own form of technical analysis, "on balance volume," to predict future stock prices. For one investment seminar, Granville dressed as Moses, carrying stone tablets and wearing a crown.

His market call to "sell everything" dropped the Dow Jones Industrial Average by 4 percent on April 22, 1980. He continued to proclaim the market was headed for imminent collapse after the last secular bull market began in 1982. His popularity declined and he later wrote a book about winning at bingo. His latest call at age 88 in January was for a 50 percent market plunge this year.

Political ambition

Another forecaster also failed to become governor of New York in one of the worst losses on record in the state. Wall Street financier Pierre Rinfret was an advisor to presidents Kennedy, Johnson and Nixon and a noted bear in the early 1980s. While on a speaking tour in New York on the very day the 1982-1999 bull market began, he said economic and stock market conditions were dismal and held no promise for recovery. Rinfret was beaten so soundly by Democrat Mario Cuomo for governor of New York in 1990 that he almost dropped the Republican line to third on state ballots.

One of the most important principles of successful investing is that it is impossible to time the markets. Perma-bears are no exception to this principle. Investors who seek guidance when times are hard and markets are falling should always remember that, as Yogi Berra once said, "it is hard to make predictions, especially about the future."

Heritage Perspective

Gold's Reputation as an Inflation Hedge Is Vastly Overstated

Gold has soared in popularity in recent years as a hedge against inflation and a hedge against weak currencies. Unfortunately for the gold bugs, a new study shows it is neither. Any holding period of less than 2000 years failed to demonstrate inflation hedging efficacy, according to investment executive Claude B. Erb and Duke University finance professor Campbell R. Harvey. Their paper, "The Golden Dilemma," which is still being revised, found that gold ownership poses an even greater financial risk than inflation.

Failed arguments

They also discounted several additional arguments for holding gold. For instance, they found that gold does not provide a good hedge against currency fluctuations. Instead, holding another country's currency to hedge against changes in one's own currency is a much better hedge, they said.

"...the volatility of gold is far higher than the volatility of inflation."

Another argument, that gold is a de facto world currency standard, does not hold water. Gold is not any country's official currency standard and has not been officially convertible into any country's currency since the year 2000.

No inflation help

Most of the arguments for gold boil down to it being an inflation hedge. Erb and Harvey looked at inflation rate variations and gold price fluctuations over rolling 10-year periods since 1975.

They found that returns on gold varied from a loss of 6 percent per year to a gain of 20 percent per year, while inflation ran at a low of 2.3 percent to a high of 7.3 percent per year. The finding "suggests that gold is not a very effective long-term inflation hedge when the long-term is defined as 10 years," because the volatility of gold is far higher than the volatility of inflation.

The authors did admit that gold may be a good inflation hedge in the very long term. Research done on the pay rate in gold for Roman soldiers under Emperor Augustus in the first century A.D. showed that the pay was almost exactly the same as the gold equivalent of the pay for U.S. Army soldiers today. This is an interesting fact, but we do not recommend you wait around for gold to prove itself.

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.

H|I|G HERITAGE INVESTMENT GROUP