



It's Your Money, Class 8:

# Money & Your Mind

Carl Lachman, MBA, CFP®



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Are we always rational when it comes to money?

Yes or no?

Why?



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No! We're irrational about money!

- We spend more when we use credit cards instead of cash. (15% more!)
- We buy things on impulse we don't need. We confuse "wants" and "needs" when it comes to spending money.
- We assume if the stock market has been going up, it will keep going up. And if has been going down, it will keep going down.



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## Why are we irrational?

- We lack knowledge.
- We lack discipline.
- But, we also have brains that are wired in a way that causes trouble with our investing.



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## Money & Your Mind

- **Part 1: Are we good investors?**
- Part 2: What about us makes investing difficult?
- Part 3: What do we need to do to be better investors?



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## Are we good investors?

Yes or no?

Why?



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## Investor report card

Example: annualized returns for 20 years through 2013.

	Index	Investor	Difference
Equities	9.22%	5.02%	-4.20%
Bonds	5.74%	0.71%	-5.03%
50/50 Portfolio	7.48%	2.87%	-4.61%

**Average investor gets an "F".**



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## Investor report card

Portfolio value at start: \$500,000  
 50/50 index portfolio after 20 years: \$2,226,037  
 50/50 average investor portfolio after 20 years: \$880,531

**Average investor underperforms by \$1,235,506!**

That's missing out on more than 50% of the possible growth!



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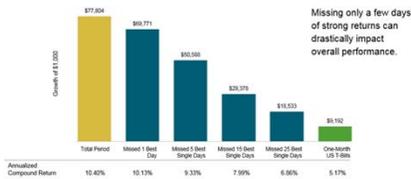
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## Our actions hurts performance

Performance of the S&P 500 Index, 1970-2013



Missing only a few days of strong returns can drastically impact overall performance.



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Vanguard study shows we receive lower returns than the funds we invest in.

Figure IV-2. Investor returns versus fund returns: Ten years ended December 31, 2017



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### Recent Nobel Prize Winner



**Dr. Richard Thaler**  
University of Chicago, Economics

- 1.) Two types of people: economists and humans.
- 2.) The humans think like humans, economists don't!
- 3.) Humans are impatient, inconsistent, and distracted by irrelevant factors.
- 4.) Financial behavior is largely a problem of self-control.



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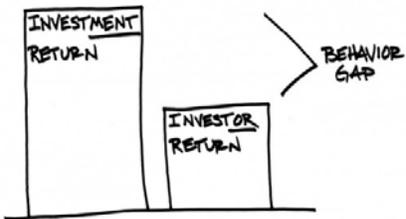
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### Behavior Gap by Carl Richards



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## Money & Your Mind

- Part 1: Are we good investors?
- **Part 2: What about us makes investing difficult?**
- Part 3: What do we need to do to be better investors?



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## What about us makes investing difficult?

Any thoughts?

Ideas?



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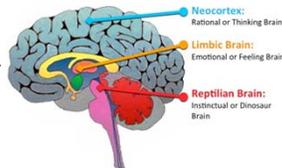
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## Why is investing difficult for us?

Our brains are wired to our investing disadvantage:

- 1.) **Reptilian brain:** brain stem.
- 2.) **Feeling brain:** limbic system.
- 3.) **Thinking brain:** neocortex.



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## Why is investing difficult for us?

Our brains are wired to our investing disadvantage:

- 1.) **Reptilian brain:** brain stem. Bodily functions. Automatic.
- 2.) **Feeling brain:** limbic system. Emotions. Reactions.
- 3.) **Thinking brain:** neocortex. Decisions. Problem solving.



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## Trouble from the feeling brain

The **amygdala** in the limbic system is the control center of emotions.

- We follow our instincts.
- We let emotions take over.
- We think more information is better.
- We take mental shortcuts.
- We are influenced by the media.



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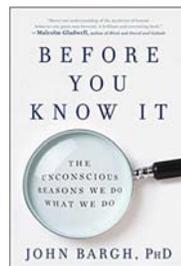
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## We follow our instincts

Should we trust our gut?

Bargh writes, "we tend to trust our gut reactions more than our rational ones because they happen so quickly we think they must be true."

Instincts are good at life-or-death choices, but not investing.



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## We follow our instincts

One of our instincts is to act.

We have a built-in bias toward action.

We think it is wrong to just do nothing.

Yet, doing a whole lot of nothing is often exactly what long-term investing is all about. Sitting and waiting, often for years.



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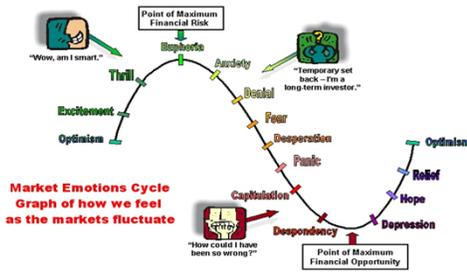
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## We let emotions take over



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## Repeat Until Broke! Carl Richards



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## We let emotions take over

Emotions can cause poor decision making.

Don't make a decision when angry, for instance. Don't impulsively react to fear or disappointment.

Step back, do something else, let some time pass, and make a list of pros and cons.



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## We let emotions take over

We really hate embarrassment. We hate it more than losing money.

In 1996, Dr. Thaler stated,

***What investors fear more than losing money is having to say...***

***"What an idiot I am!"***



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## We let emotions take over

Remember that fear is one of the most basic emotions.

The fear of financial failure AND fear of physical harm have the same response and effect in our bodies!



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## We think more info is better

Sometimes we think if we just do some more research or reading or get another adviser's opinion, we will finally know what to do.

However, we usually get overwhelmed by too much information.



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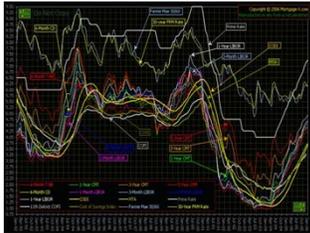
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## We take mental shortcuts

**We get overwhelmed by data, so we use shortcuts.**

We can only analyze 5-9 variables, at a maximum.

This graph has so much information, that our brains immediately try to simplify it.



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## We take mental shortcuts

**Our brains burn 1/4<sup>th</sup> of the calories our bodies use each day.**

**Our bodies are always trying to get us to think less to conserve energy!**



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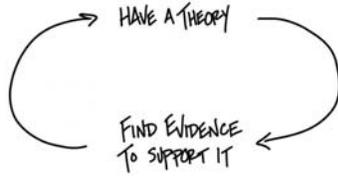
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## We take mental shortcuts

**We filter information and are biased to whatever confirms our preconceived ideas.**

This is confirmation bias, as shown by Carl Richards drawing.



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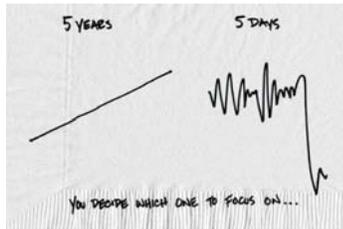
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## We take mental shortcuts

**We forget the longer past and are unduly influenced by recent results.**

This is recency bias.

Which should we focus on? Carl Richards



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## We take mental shortcuts

**We go with what others are doing and thinking.**

This is herding bias.



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## We are influenced by the media



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## The media sells greed

The investment entertainer Jim Cramer has used the following tag line for marketing his books, TV shows, and podcasts. He says...

**"You Can't Afford To Miss It!"**



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## A Bad Idea – Carl Richards



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## The media sells fear

- It's a **blood bath** on Wall Street today!
- The financial markets are in **freak-out mode!**
- The company is **too big to fail!**
- The stock market is **crashing!**



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## The media sells fear

By appealing to our emotions, the media increases viewership and increases advertising revenue, but also causes us to make poor decisions.

Dr. Thaler and his student Werner De Bondt hypothesized in the 1980s that **“people tend to overreact to unexpected and dramatic news events, driving stock prices out of whack.”**



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## The media to the rescue

Jim Cramer was famously interviewed in February, 2009, and stated that investors should sell enough investments so that they had all the cash they needed for 5 years.

Guess what happened a month later...



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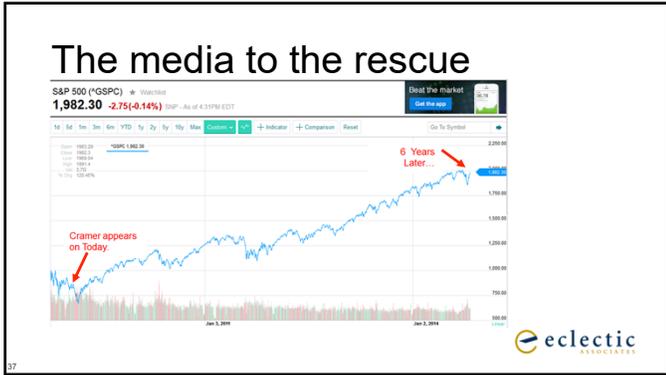
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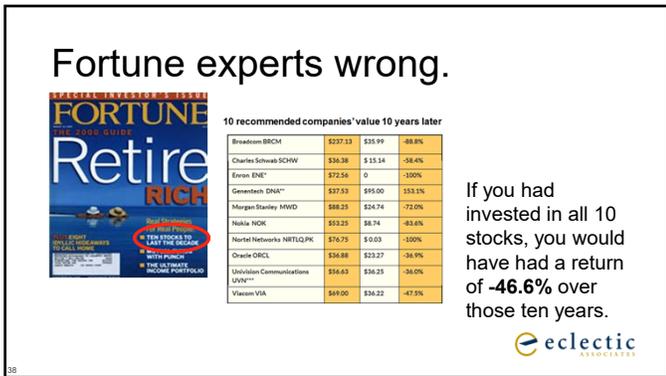
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### CNBC experts wrong.

Jim Cramer in March 2008 said that Bear Stearns was fine. 6 days later it was bankrupt.

Power Lunch said Lehman Brothers was “No Bear Stearns!”, but it was bankrupt 3 months later in 2008.

The Faber Report said Merrill Lynch had no need to raise additional capital, but ran out of money 5 months later and was bought by Bank of America.



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### What happened? Carl Richards



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Real experts don't give away their best ideas.



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## Trouble from the feeling brain

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## Money & Your Mind

- Part 1: Are we good investors?
- Part 2: What about us makes investing difficult?
- **Part 3: What do we need to do to be better investors?**



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What should we do to be better investors?

Any thoughts?

Ideas?



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## What do we need to do?

To be better investors, we need these six things:

- 1.) **Discipline**
- 2.) **Diversification**
- 3.) **Allocation**
- 4.) **Rebalancing**
- 5.) **Minimize costs**
- 6.) **Accountability**



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## 1.) **Discipline:** follow a disciplined investment strategy.

- Think through your strategy at a "quiet time".
- Write down your strategy and commit to it.
- At times of high emotion, stick with your strategy.

*Success in investing doesn't correlate with I.Q. Once you have ordinary intelligence, what you need is the temperament to control urges that get other people into trouble in investing.*

Warren Buffett



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## 1.) **Discipline:** follow a disciplined investment strategy.

Dr. Thaler wrote with Dr. Sholomo Benartzi of UCLA business school...

***"Investors hate losses more than they love gains, and they focus too much on the near term, even when it comes to long-term investment goals, like retirement."***



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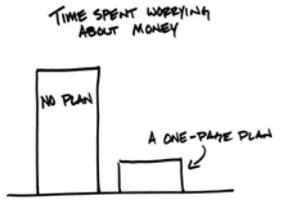
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# 1.) Discipline: follow a disciplined investment strategy.

Even a short, written plan will decrease worry. Carl Richards



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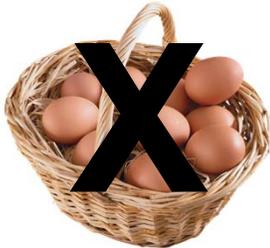
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# 2.) Diversification: you need a variety of investments.



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# 2.) Diversification: you need a variety of investments.



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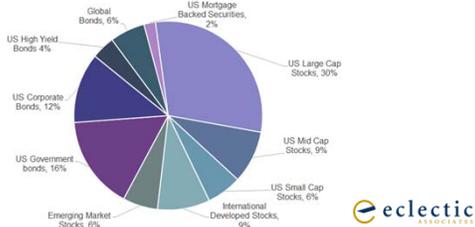
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### 3.) Allocation: create a plan for the variety in your investments.

This is just an illustration of a portfolio allocation. It is not a good allocation for your portfolio.



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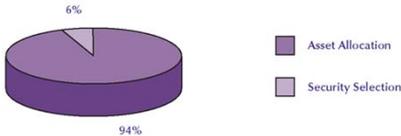
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### 3.) Allocation: the variety plan is the most important decision.

Asset Allocation vs. Security Selection: What's Really Important?

Asset Allocation is the most important decision and determines over 90% of an investment portfolio's long-term returns and short-term volatility.



SOURCE: Brinson, Gary, Randolph Hood and Gilbert Beebower. 1986. "Determinants of Portfolio Performance" Financial Analysts Journal.



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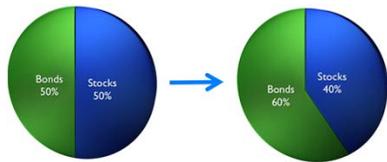
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### 4.) Rebalance: at least twice a year, get back to targets.



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### 5.) Minimize costs: save money on fees and taxes.



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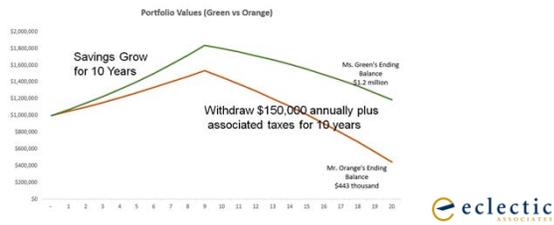
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### 5.) Minimize costs: save money on fees and taxes.



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### 6.) Accountability: select the right kind of advisor.

- Ask First!
- What is their experience?
- What is their education?
- Are they licensed to sell you something?
- How do they get paid?
- Are they held to the fiduciary standard?



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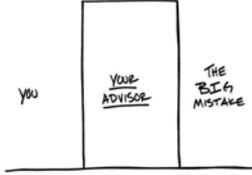
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## 6.) **Accountability:** select the right kind of advisor.

Your advisor can stand in the way of your big mistake.

Carl Richards



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## What do we need?

To be better investors, we need these six things:

- 1.) **Discipline:** write down your investment strategy.
- 2.) **Diversification:** have a variety of investments.
- 3.) **Allocation:** create a plan for your variety of investments.
- 4.) **Rebalancing:** at least twice a year, get back to targets.
- 5.) **Minimize costs:** save money on fees and taxes.
- 6.) **Accountability:** select the right kind of advisor.



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## Money & Your Mind

- Part 1: Are we good investors?
- Part 2: What about us makes investing difficult?
- Part 3: What do we need to do to be better investors?



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# Thank you!

Contact me for a free meeting.

Carl Lachman, MBA, CFP®  
Vice President  
**Eclectic Associates**  
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714-738-0220  
[clachman@eclecticassociates.com](mailto:clachman@eclecticassociates.com)



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# Eclectic Associates' Mission:

*To help our clients achieve peace of mind about their money and their future.*



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**Call or email for a free meeting.**



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# Providing the Essentials for Your Financial Peace of Mind

At Eclectic Associates, we offer the essentials of financial planning and we don't make promises that we can't back up. Instead, we provide experienced advice and a comprehensive plan to help give you clarity and the freedom to enjoy the rest of your life.

## How We Help

- **We are fee-only.** We don't accept commissions and we don't sell products. We get paid only by you.
- **We are fiduciaries.** We give advice that is only in your best interest.
- **We have expertise.** Our credentials include the CFP® and CFA designations, as well as the MBA degree.
- **We have a large team.** Our large team of financial planners can help you feel confident that we will always be there for you.
- **We are independent.** We are not beholden to anyone's interests but yours.
- **We are experienced.** We have been in the business of financial planning since 1984.

## Who We Help

- **Pre-retirees** who realize that retirement is finally "real" and it's **time to get serious about the future.**
- **Retirees** who want to make sure that they are **not going to outlive their money.**
- **Investors** who are **anxious about their portfolio** and are unsure if their current advisor is really helping them.
- **Business owners** who want to **protect their livelihood and their family** from the risk and volatility of their company.
- **Professionals** who are **changing jobs** and have to determine what to do with their prior company's 401(k) plan.
- **Widows and widowers** who are facing **major changes** in their financial situation.
- **People who have received a windfall**, such as an inheritance or property sale, and **want help optimizing it.**

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- Financial planning
- Retirement planning
- Investment management
- Cash flow analysis
- Insurance evaluation, including life and long-term care
- Tax strategies
- Company retirement plans
- Debt management
- Social Security optimization
- Education funding
- Health insurance guidelines
- Medicare evaluation
- Estate planning
- Charitable giving

## Schedule a 15-Minute Call

Let's see how we can help you achieve peace of mind about your money and your future. Schedule your complimentary call today: [www.eclecticassociates.com](http://www.eclecticassociates.com).



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Fullerton, CA 92833

**web** [www.eclecticassociates.com](http://www.eclecticassociates.com)  
**phone** 714-738-0220

# "Ask First!"

This form is to be filled out by any person who is offering legal, financial, retirement, insurance, accounting, estate, long-term care or similar planning services. Respond to **ALL** categories completely; sign and date at the bottom of the page.

**MY EDUCATION-** I have achieved the following level of education (check HIGHEST level achieved):

Some High School	Some College
GED	Bachelors Degree - <b>Econ w/ math minor (Occidental)</b>
High School Diploma	Masters or Other Advanced Degree - <b>MBA (UCLA)</b>

**MY CREDENTIAL(S)-** I have the following specialized credential(s) and training:

**CFP® – Certified Financial Planner.** I have worked as a financial planner since 2003. I am a member of the Financial Planning Association (FPA) and the National Association of Personal Financial Advisors (NAPFA), and I am required to complete continuing education each year.

**MY RELEVANT LICENSE(S)-** I have the following license(s) giving me the legal authority to provide the services I am offering to you (bar license (attorney); securities license; insurance license):

Registration Type	Covers What Activities	Issued By	Registration No.
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**LEGAL SERVICES -** (Check ONE):

I DO NOT practice law, and the services I am offering to you do not involve practicing law.

- I DO practice law, and have an active license to practice law in California.
- I DO practice law, but DO NOT have an active license to practice law in California.

**OUR BUSINESS RELATIONSHIP: FIDUCIARY AND CLIENT**

**TRUE – In our business relationship, I am legally held to the fiduciary standard, so I will put your interest before my interests and those of my employer.**

**MY COMPENSATION-** I will be paid in the following way (commission, fee, salary, etc.), by the named person or company, in connection with the services I am offering to you:

Way(s) I'll Be Paid: **FEE ONLY** Payment will be made by: **CLIENT ONLY**  
**1.0% annually on first \$1,000,000 of investment assets. Fee drops thereafter.**

**FINANCIAL PRODUCTS / AFFILIATED ORGANIZATIONS -** Check TRUE or FALSE:

**FALSE: I do not sell any financial products, my business does not sell any products, and we are not affiliated with any business that sells financial products.**

<b>I certify under penalty of perjury that the responses herein are true to the best of my knowledge.</b>	
Date: 4/1/2014	Business Name: <b>Eclectic Associates, Inc.</b>
Signature: 	Address: <b>1021 West Bastanchury Rd. #120, Fullerton, CA 92833</b>
Print Name: <b>Carl Lachman</b>	Email address: <b>clachman@eclecticassociates.com</b>
Telephone: <b>714-738-0220</b>	Website: <b>www.eclecticassociates.com</b>