THE STAN CLARK FINANCIAL TEAM'S
PERSPECTIVES
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Behavioral Finance

FIVE TOOLS TO AVOID THE PITFALLS OF FINANCIAL SIRENS

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Last month, we explored the Ulysses Contract – the powerful strategy that helps avoid making investment mistakes due to ingrained biases. Based on Homer's classic story, this agreement commits us to wise actions we won't later change on a whim.

In the original story, Ulysses arranged for his crew to plug their ears with wax, then row him past the sweetly singing Sirens. According to the agreement, the crew would keep Ulysses bound with rope to the mast, his own ears unplugged. That way he could hear the Sirens' hauntingly beautiful song without the risk of leaping into the sea under their lethal spell.

In this issue, let's talk about some important tools we can use to avoid the pitfalls of *Financial* Sirens.

Readers of my articles on behavioral finance know that a wide range of natural biases makes it hard to invest without emotion. Even knowing about the biases won't guarantee avoiding the errors they cause. Like Ulysses, we will be better off using tools, as he did with the wax and the rope, to keep from being influenced too much by biases.

Here are five of the specific tools we use at the Stan Clark Financial Team:

1. Disciplined Stock Strategies – Intuitively it's appealing to learn a company's story, or "get to know" the CEO or top management. However, a smooth-talking CEO, or a company that seems on a roll, can be like the Sirens. They look and sound good, and may be difficult to resist. This can lure even experienced investors into making big mistakes. But by using objective rules to select stocks, rather than relying on subjective judgment and faulty intuition, you can avoid making serious emotional mistakes.

2. Investment Policy Statement (IPS) – With this document, you set guidelines for managing your portfolio, such as how to spread out your money and what strategies to use. An IPS also lays out how to manage risk through diversifying your investments by strategy, country and industry. Making those decisions up front and writing them down helps you avoid the common mistake of buying high and selling low.

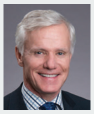
3. Equities Targets – You set a fixed percentage of your portfolio to hold in equities. By setting an equities target and sticking to it, you automatically add stocks when markets are low, and reduce them when markets are high. This helps you avoid the common errors that come from trying to time the market. It also helps you to automatically profit from the market's ups and downs.

4. Discretionary Managed Portfolio – Here you authorize an advisor to manage your portfolio on your behalf, following your IPS guidelines. Your advisor can now make decisions without your having to approve every buy and sell. This is a good way to stick to your investment strategy, especially if you are the sort of investor who would otherwise get overly involved in buying and selling decisions.

5. Personal Financial Plan – This written plan helps you make saving and spending decisions by evaluating the trade-off between your short-term and long-term financial goals. Your plan helps you decide if you can retire early, or if you need to work longer. It's also a useful way of getting investors who tend to focus too much on short-term results to adopt a longer-term perspective. And, it helps you stick to your investment plans.

Our team uses tools like these to avoid the pitfalls of Financial Sirens. These tools help you avoid many common financial errors – so you can enjoy the sweet song of financial success!

Knowing about these biases can help. But merely knowing about them doesn't make them disappear. We have to constantly guard against being influenced by them. It sometimes helps to use certain tools, or tricks, to help us make the right financial decisions. I'll write about these next month.



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