QUICK MARKET UPDATE

Handicapping Your Investment Skill

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It's April and spring is in bloom. For us, this year, we specifically are enjoying the emergence of the Texas bluebonnets, the Masters golf tournament on television, and that DALBAR, Inc., just released its 2012 edition of their annual survey: The Quantitative Analysis of Investor Behavior (QAIB). For anyone not familiar with the latter, let us explain.

The QAIB is an annual study that has been conducted each year since 1994 which seeks to measure how the average investor fared in the past year and on a three, five, 10 and 20 year rolling basis. DALBAR compiles data on flow of dollars into various categories of mutual funds to build a return profile of an "average equity investor" and an "average fixed income investor." The returns of these "average investors" can then be evaluated against representative market indices.

With a nod to the Masters, it is like keeping score in golf, where the market index is "par for the course" and the player's skill can be evaluated based on being above or below par. If you're a bad golfer, you can look at your score and determine where you are making mistakes. Similarly, the DALBAR scorecard for the average investor allows us to gain insight into the mistakes that investors make. Do investors attempt to time the market? If they do, do their timing decisions add value; or do they hurt themselves by making emotionally driven timing decisions and getting the market direction wrong?

Investors Double-Bogey in 2011

DALBAR has scored the returns of the average equity and average fixed income investor for 2011. The results are not good. According to the 2012 QAIB report, both equity and fixed income investors underperformed in 2011.

For the year ending December 31, 2011:

- The average equity fund investor experienced a loss of 5.73%. That is compared to the gain of 2.12% (dividends included) if they simply held the S&P 500 Index. That means the average equity fund investor trailed the S&P 500 by almost 8%!

- The average fixed income fund investor experienced a gain of 1.34%, significantly below the 7.84% return of the BarCap Aggregate Bond Index. That means the average fixed income fund investor trailed the index by over 6%!

Skeptics might counter that a one year timeframe is not a long enough time period to evaluate investor behavior. Fortunately, DALBAR has been conducting this study since 1994.

What is Your Investment Handicap?

A golfer's skill can be determined by comparing their score in multiple rounds of golf to par and averaging the results. The disciplined professionals invited to play at the Masters all can play, on average, a round of golf at par or better – they can match or beat the index. Then there are the rest of us. We are not diligent enough in our practice to execute on the course and we frequently make poor decisions based on the fear of hitting the ball into a hazard. Yet, we think we are better than we are in reality. We think we do not carry a handicap, and are surprised when we make mistakes.

It turns out the average investor also carries an investment handicap. We can look at each year an investor is in the market and consider that a round of investment. After multiple rounds, or years, of investment, we can look at the difference in the average investor return and the index return and calculate the average investor handicap.

Unfortunately, as the DALBAR results in the chart below illustrate, the average investor handicap for both equity and fixed income is negative over one, three, five, 10, and 20 year rolling periods.

	Avg. Equity Investor	**S&P 500**	**Difference**	**Avg. Fixed Income Investor**	**BarCap Aggregate Bond Index**	**Difference**
12 month	-5.73%	2.12%	-7.85%	1.34%	7.84%	-6.50%
3 Year	12.56%	14.11%	-1.55%	4.07%	6.77%	-2.70%
5 Year	-2.21%	-0.25%	-1.96%	0.95%	6.50%	-5.55%
10 Year	2.39%	2.92%	-0.53%	0.93%	5.78%	-4.85%
20 Year	3.49%	7.81%	-4.32%	0.94%	6.50%	-5.56%

Returns over 1 year are annualized. Performance is as of December 31, 2011.

Fortunately, a poor round of golf ends when you walk off the course. Unfortunately, a poor round of investment can have significant and devastating impact on your future. There is much more at stake. Because of these high stakes, we should identify the mistakes investors typically make and find ways to try to avoid repeating the mistakes in the future.

It's All in Your Head

Disciplined golfers know the game comes down to positioning. If you hit your ball down the middle of the fairway, you should be in a position to carry the water hazard on the next shot. Weekend warriors start to worry about the water hazard well before they get to it. As a result, they panic and hit it into the rough. They are so gripped by fear that they make all kinds of mistakes while attempting to avoid a hazard.

The average investor is like the weekend warrior - so gripped by fear of the next downturn that they try to avoid it by selling out of their investment portfolio. Then, when markets have risen and it appears there are no hazards on the horizon, greed takes over and they get back into the market. The 2012 QAIB study proves empirically that investors try to time their way through the market cycle, and more important, that investors get it wrong more often than not. The result: a negative investment handicap.

In fact, DALBAR calculates what they call a *Guess Right Ratio* for investors. The ratio is based on a correct market decision – where an investment inflow is followed by a market gain and an investment outflow is followed by a market loss. In 2008 and 2009, the investor Guess Right Ratio was only 42%, meaning investors generally were wrong in predicting the direction the market. An examination of fund flows confirms that inflows FOLLOW rather than precede market gains, and outflows follow rather than precede market losses. This is exactly what we don't want to happen when investing.

Who is the Guy in the White Overalls?

If you watch any of the Masters, the coverage will focus on the players. Something which will not be mentioned often, but is there for everyone to see if you pay attention to it, is the guy standing next to each player. At the Masters, that guy is wearing white overalls and a green cap. He is the player's caddy. While the actual shots are hit by the players, the caddy is providing the player with advice: making club selections and pointing out risks, opportunities, hazards and safe landing areas. Also, the caddy helps the player manage their emotions by helping to determine which risks are and which risks aren't reasonable risks to take. Their advice may change depending on the course conditions, but overall, they help to add discipline to the game.

Like a caddy, an H.D. Vest Advisor is there to help clients navigate the investment course. They are there to help define goals and objectives, and to make recommendations on investment products and strategies that are suitable to pursue those goals and objectives. And, H.D. Vest Advisors are there to help manage emotions when market conditions spur fear or greed, so that investors are less likely to make decisions which may only serve to add to their investment handicap.

As always, we suggest addressing any concerns by starting or updating a financial plan which addresses your specific goals and objectives. Should you have questions about the implications of market conditions, we suggest discussing your concerns with your H.D. Vest Advisor

Disclosures:

Unless otherwise indicated, source for data presented: "Quantitative Analysis of Investor Behavior, 2012," DALBAR, Inc. www.dalbar.com

Equity benchmark performance and systematic equity investing examples are represented by the Standard & Poor's 500 Composite Index, an unmanaged index of 500 common stocks generally considered representative of the U.S. stock market. Indexes do not take into account the fees and expenses associated with investing, and individuals cannot invest directly in any index. Past performance cannot guarantee future results.

Bond benchmark performance and systematic bond investing examples are represented by the Barclays Aggregate Bond Index, an unmanaged index of bonds generally considered representative of the bond market. Indexes do not take into account the fees and expenses associated with investing, and individuals cannot invest directly in any index. Past performance cannot guarantee future results.

Average stock investor, average bond investor and average asset allocation investor performance results are based on a DALBAR study, "Quantitative Analysis of Investor Behavior (QAIB), 2012." DALBAR is an independent, Boston-based financial research firm. Using monthly fund data supplied by the Investment Company Institute, QAIB calculates investor returns as the change in assets after excluding sales, redemptions and exchanges. This method of calculation captures realized and unrealized capital gains, dividends, interest, trading costs, sales charges, fees, expenses and any other costs. After calculating investor returns in dollar terms, two percentages are calculated for the period examined: Total investor return rate and annualized investor return rate. Total return rate is determined by calculating the investor return dollars as a percentage of the net of the sales, redemptions, and exchanges for the period.

An investment cannot be made directly into an index

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The S&P 500 is an index of 500 major, large-cap U.S. corporations.

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