KAM COMMENTS

KRUSE ASSET MANAGEMENT, LLC

WHAT A RIDE!

The first issue of KAM Comments warned about potential volatility coming. Furthermore, it was advised that should we see a pull-back, *Do Not Panic!* In the past 90 days, we saw all-time market highs, a pull-back to multi-year lows and then a return back to those high levels again (see chart of the S&P 500 over the past quarter). Those who gave into the emotions of the situation when the market was falling, lost out on the upside that ensued immediately thereafter.

The moral of the story is that we should do our best to ignore the short term fluctuations that will inevitably happen and focus on long-term investment plans to achieve our goals.

VOLUME 1, ISSUE 2

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Did you know?

* Most of the gains in the stock market occur between the months of October though April.
* The Canadian dollar reached parity with the US dollar for the first time in over 30 years.
* Adjusted for inflation, in today's dollars, crude oil hit an all-time high of over $100/barrel in 1979.

FINANCIAL BEHAVIOR BASICS

John Keynes, a famous financial mind, once said, *"It is better for reputation to fail conventionally than to succeed unconventionally."*

The fact that we, as human beings, have a tendency to invest contrary to our own best interests just so we feel better about our potential failure, is not conducive to making wise investment decisions.

To understand Financial Behavior is to understand our investing biases so that we may overcome them in the future.

For example: say you need to sell one of two stocks in your portfolio — one has a gain and one a loss. Which would ***you*** want to sell?

The average investor will sell the stock with the gain so that he can lock in the profit and his own personal victory, while holding onto the loser in hopes that it will rebound so that a mistake will not have to be realized. This is called the "Disposition Effect" and research indicates that this behavior is exactly the opposite strategy one should adopt to have continued long-term success.

Over the next few quarters we will examine biases that most investors have, such as:

- Recency Effect
- Disposition Effect
- Mental Accounting
- Endowment Effect

When investors fall prey to these tendencies, they often take actions based on emotions that are exactly opposite to their goals of preserving and/or increasing their long-term wealth.

In the mean time, beware of investing on how your "feel," and try to take your emotions out of the investment process.

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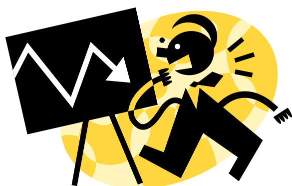
Improving Your Odds of Reaching Your Goals



"The advantage of emotions is that they lead us astray."
— *Oscar Wilde*

TOP SECURITY SCAMS

Affinity Fraud - Con artists may pretend to be or actually become members of a particular group to gain a person's trust. Often the leader of that group may become a victim of the scam as well.

Foreign Exchange Trading - "ForEx" trading is a legitimate part of the financial markets, but individuals should be wary of promises of unusually high returns.

Internet Fraud - Scammers continue to take advantage of technology to lure investors into "pump-and-dump" stock schemes.

Investment Seminars - Promoters of unsuitable investments are increasingly seeking potential investors.

Oil and Gas Schemes - Rising oil and natural gas prices have made a variety of traditional and alternative energy projects attractive to investors.

Promissory Note Schemes - Con artists peddling promissory notes promise above-market interest rates and safety of principal.

Private Securities Offerings - Con artist are increasingly turning to private securities offerings under Rule 506, Regulation D of the Federal Securities Act of 1933, to attract investors without having to go through the registration process. Some offerings are valid, so be sure to do your research.

Real Estate Investment Contracts - Investments in Real Estate have been viewed with little downside risk and the potential for substantial returns, but this is not always the case.

Unlicensed Individuals and Unregistered Products - Anyone selling securities or providing investment advice about buying or selling securities must be properly licensed.

Unsuitable Investment - What might be a suitable investment for one investor may not be right for another.

SOUND PORTFOLIO CONSTRUCTION

The basic concept of *diversification* is to add different types of assets to your portfolio so that your overall portfolio becomes less risky ***and*** potentially more profitable. Less risk and more profit is a win/win scenario, but how does it work?

Here is a very simple example: Let's say you have only two different types assets you can choose to invest in: Asset S and/or Asset B.

Asset S has an average return of 12%, and has a volatility (risk) of 22%, while Asset B has an average return of 7% and volatility of 10%.

If you want the safest portfolio, you might be tempted to invest 100% of your money into Asset B in hopes of a 7% return and a volatility of 10%.

However, diversification works because Asset B and Asset S do not move in lock-step all the time. In this example, if the correlation of Asset S and Asset B is 20%, changing your investment mix by investing only 90% into Asset B and the other 10% into the more risky Asset S, may yield unexpected results: The overall portfolio would have a higher return of 7.5% and a volatility of 9.7% — ***More potential return with less risk!***

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Before making any investment decisions, consult with an investment professional about your particular situation.

Past performance is no guarantee of future results.