CNB Wealth Management

QUARTERLY PERSPECTIVE

WINTER 2019

Managing Investor Behaviors

With deference to March's lion and lamb, 2018 came in like a bull and went out like a bear. All major global stock market indices finished negative for the year, and fixed income returns were flat to modestly positive in the U.S. and mostly negative internationally. From January through September of 2018, U.S. stock market returns were strong, while foreign performance lagged. By the time the dust had settled on the fourth quarter, Federal Reserve, China trade and Washington political issues were fully involved, and a complete and total market reversal had occurred. The Christmas Eve trading day was the worst December 24th on record, and the S&P 500's December drop was the worst since the Great Depression (LPL Financial). Here are the year's numbers segmented:

2018 Performance	First Three Quarters	Fourth Quarter	Full Year 2018
S&P 500 Index	10.56%	-13.52%	-4.38%
Dow Jones Industrial Average	8.83%	-11.31%	-3.48%
Nasdaq Composite (tech)	17.48%	-17.29%	-2.84%
Russell 2000 Index (small cap)	11.51%	-20.20%	-11.01%
MSCI EAFE (net) (foreign developed)	-1.43%	-12.54%	-13.79%
MSCI Emerging Markets (net)	-7.68%	-7.47%	-14.58%
Bloomberg Barclays U.S. Aggregate Bond Index (bonds)	-1.60%	1.64%	0.01%
BofA Merrill Lynch 3-month Treasury Bill (cash)	1.30%	0.56%	1.87%

Source: Zephyr StyleADVISOR

The pain of losing money during the fourth quarter likely stirred more emotion in investors than the joy of making money over the previous three quarters (or the past few years for that matter). If acted on, this ***loss aversion*** behavior could have easily put an investor's financial plan at risk. A recent study by DALBAR, a financial research firm, has shown how the general temptation for investors to try and time the stock market often results in the investor jumping into the market at the top and fleeing it at the bottom. This activity has actually caused average investor results to significantly underperform the broader markets over the long term, as seen in the chart at right.

The relative underperformance of the average investor is significant, and implies a real loss in potential portfolio market value. In ***hindsight***, most investors would have been better served by staying invested during all stages of the market.

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GEOFF BLYTH

Senior Vice President

Senior Investment Strategist

Geoff is responsible for the oversight of CNB Wealth Management's investment process, managing portfolio strategies, investment research, client relationships and the rebalancing of client asset allocations. He is a holder of Certificate in Applied Behavioral Finance by the Cannon Financial Institute.

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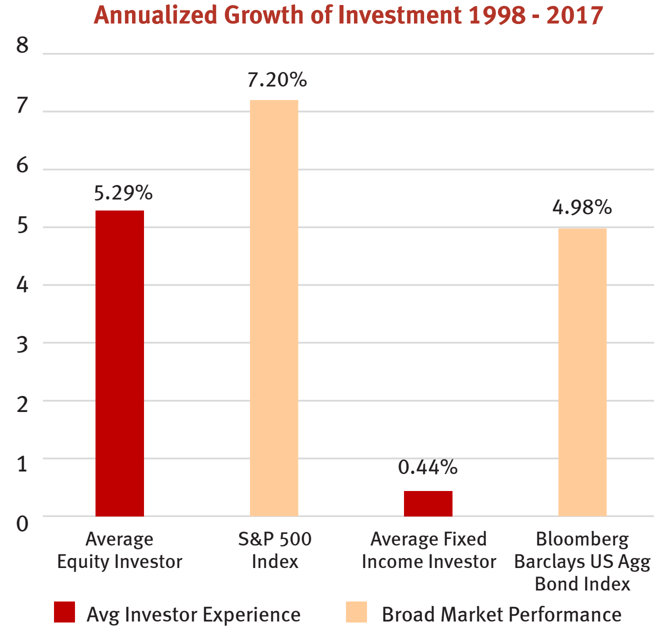
Annualized Growth of Investment 1998 - 2017



Source: DALBAR, Investment Company Institute

Bad investing habits may not be completely excised, but they can be managed. Standard theoretical finance holds the notion that investors are inherently rational economic beings. Behavioral finance believes that investors can also be irrational, i.e. human, and, therefore, susceptible to allowing personal beliefs and biases to influence their decision-making (see DALBAR results on previous page to evaluate that success). That's why understanding expected investor reactions to portfolio ups and downs is critical to reinforce the confidence necessary to weather stormy market cycles. With a potential global slowdown on the horizon as tighter financial conditions and increased political and economic uncertainties weaken "animal spirits," now is as good a time as any for investors to prepare for continued volatility and learn to minimize potentially harmful biases.

These human habits, or prejudices, can be both cognitive and emotional. Some of the more common investor biases are:

- Illusion of Control: belief that one can control or influence outcomes when, in fact, they can't
- Hindsight: retrospectively perceive an event was predictable, even when it wasn't
- Recency Bias: emphasize recent events and observations more prominently than those occurring in the past
- Outcome Bias: tendency to take a course of action based on the result of past events, not the process that produced the result
- Anchoring Bias: inclination to use a purchase price as a reference point in making a future decision
- Loss Aversion: feel the pain of losses more than the pleasure of gains
- Affinity Bias: tendency to buy things one believes will reflect their values
- Cognitive Dissonance: new information that conflicts with preexisting beliefs causes mental discomfort
- Conservatism: clinging to prior views or forecasts and ignoring new information

Your CNB wealth advisor's ability to recognize these biases and appropriately intervene is critical in order to help clients make better decisions with regard to their wealth. Ultimately, the intent is always to follow the plan and work to avoid the behaviors that tend to sabotage "staying the course." While we enjoy close, personal relationships with our clients, we follow a disciplined process that allows us to be professionally objective in implementing their financial plans. Consider us an insurance policy that safeguards clients falling prey to the behaviors above. To ensure that we keep clients on track toward success in managing their plans, it's equally important we understand their financial goals, maintain a consistent approach, and deliver on their expectations. As your advisor, we need to:

- **Listen** carefully for meaning and feeling
- **Clarify** to confirm mutual understanding
- **Empathize** and be helpful, but firm
- **Explore** alternative actions, when necessary
- Suggest an **Answer** that is appropriate
- **Confirm** agreement before moving forward

Now is always a good time for you to meet with your wealth advisor to review your financial plan and make sure it continues to fulfill your needs and objectives. Your CNB Wealth Management advisor team stands ready to provide you with all of the investment and financial planning tools necessary to ensure your plan stays on track through all types of markets, no matter what real or perceived obstacles stand in the way.

Did you donate to charity from your IRA in 2018?

If you are over the age of 70 ½, did you use a Qualified Charitable Distribution (QCD) from your IRA to make some or all of your donations? If your answer is yes, please note the important message below when preparing your 2018 tax returns:

- Federal Form 1099-R will report total distributions from your IRA. **It will not, however, report any Qualified Charitable Distributions** which represent the non-taxable portion of your distributions. It is up to you to report this to the IRS on your tax return.

If you use a tax preparer, be sure to let your preparer know about your 2018 direct charitable distributions so that the taxable portion of your IRA distributions is represented correctly. If this is not done, you will not receive a tax benefit for charitable gifts made from your IRA. Also note that if you reduce the taxable portion of your IRA distributions by the QCD, you cannot then claim a corresponding charitable deduction.