

Introduction to the ABCs of Behavioral Biases

By now, you've probably heard the news: **Your own behavioral biases are often the greatest threat to your financial well-being.** As investors, we leap before we look. We stay when we should go. We cringe at the very risks that are expected to generate our greatest rewards. All the while, we rush into nearly every move, only to fret and regret them long after the deed is done.

Why Do We Have Behavioral Biases?

Most of the behavioral biases that influence your investment decisions come from myriad mental shortcuts we depend on to think more efficiently and act more effectively in our busy lives.

Usually (but not always!) these short-cuts work well for us. They can be powerful allies when we encounter physical threats that demand reflexive reaction, or even when we're simply trying to stay afloat in the rushing roar of deliberations and decisions we face every day.

What Do They Do To Us?

As we'll cover in upcoming newsletters, those same survival-driven instincts that are otherwise so helpful can turn deadly in investing. They overlap with one another, gang up on us, confuse us and contribute to multiple levels of damage done.

Friend or foe, behavioral biases are a formidable force. Even once you know they're there, you'll probably still experience them. It's what your brain does with the chemically induced instincts that fire off in your head

long before your higher functions kick in. They trick us into wallowing in what financial author and neurologist William J. Bernstein, MD, PhD, describes as a "Petrie dish of financially pathologic behavior," including:

- **Counterproductive trading** – incurring more trading expenses than are necessary, buying when prices are high and selling when they're low.
- **Excessive risk-taking** – rejecting the "risk insurance" that global diversification provides, instead over-concentrating in recent winners and abandoning recent losers.
- **Favoring emotions over evidence** – disregarding decades of evidence-based advice on investment best practices.

What Can We Do About Them?

Over the next several newsletters we'll discuss the "ABCs of Behavioral Biases," so that you can more readily recognize and defend against them the next time they're happening to you.

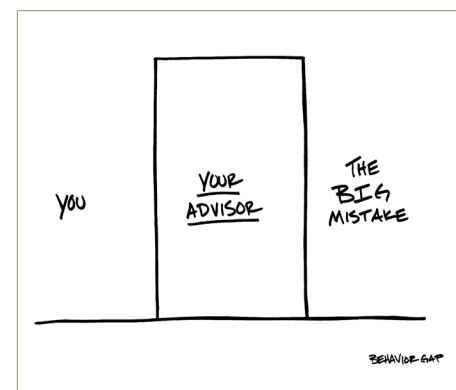
Here are a few additional ways you can defend against the behaviorally biased enemy within:

Anchor your investing in a solid plan – By anchoring your trading activities in a carefully constructed plan (with predetermined asset allocations that reflect your personal goals and risk tolerances), you'll stand a much better chance of overcoming the bias-driven distractions that rock your resolve along the way.

Increase your understanding – Don't just take our word for it. Here is an entertaining and informative library on the fascinating relationship between your mind and your money:

- "Predictably Irrational," Dan Ariely
- "Why Smart People Make Big Money Mistakes," Gary Belsky, Thomas Gilovich
- "Stumbling on Happiness," Daniel Gilbert
- "Thinking, Fast and Slow," Daniel Kahneman
- "The Undoing Project," Michael Lewis
- "Nudge," Richard Thaler, Cass Sunstein
- "Your Money & Your Brain," Jason Zweig

Don't go it alone – Just as you can't see your face without the benefit of a mirror, your brain has a difficult time "seeing" its own biases. Having an objective advisor well-versed in behavioral finance, dedicated to serving your highest financial interests, and unafraid to show you what you cannot see for yourself is among your strongest defenses against all of the biases we'll present throughout the rest of this series.



As you learn and explore, we hope you'll discover: You may be unable to prevent your behavioral biases from staging attacks on your financial resolve. But, forewarned is forearmed. You stand a much better chance of thwarting them once you know they're there!

Next quarter we'll begin our A-Z introduction to many of the most common behavioral biases.

David Bromelkamp
President and CEO

Financial Planning Tip

The end of 2017 is rapidly approaching. This is a good time to review and evaluate your financial situation so you can benefit from some year-end planning strategies. Many custodians require paperwork to be completed long before December 31st, so be sure to move quickly:

- Harvest tax losses:** Review your portfolio and current year realized gains and losses to determine whether you should harvest some tax losses or potentially harvest gains. It may be a better strategy for you to recognize gains if you think your tax bracket will rise next year.
- Pre-pay property taxes:** Pay property taxes due in January before the end of the year if you plan to claim them as a deduction.
- Charitable donations:** Donate cash, appreciated securities and household items before the end of the year to claim a charitable tax deduction.
- Roth conversion:** Consider converting a portion of your IRA to a Roth IRA to maximize the rest of your tax bracket and “pre-pay” tax if you believe your tax rate may be higher in the future.
- IRA contribution:** Contribute as much as possible to IRAs or Roth IRAs before the April 2018 deadline.
- Prepare for the new tax year:** Start a folder to hold all tax-related documents that will begin to arrive in early 2018.
- Increase retirement plan contributions for 2018:** Maximize your tax deferral options in your work-related retirement plans. Take advantage of catch-up contributions if you are eligible. If you received a raise, use a large portion of it to increase your retirement plan contributions going into the new year.

Headlines

- We had a great time with clients, friends and colleagues at the October 2017 Allodium Wealth Management Workshop featuring keynote speaker Mark Lanterman on cyber security and the dark web.
- Allodium was pleased to welcome two new clients in the third quarter of 2017.
- Our office will be closed on December 25th and January 1st for company holidays.

Note: To find out more about Allodium's breaking news, please visit our website: www.aicria.com.

NEWS:

Upcoming Increases You Need to Know:

- Good news! In Minnesota, 529 plan contributions are now deductible up to:
 - a. \$1,500 per single person or \$3,000 for married couples
 - b. Alternatively, you may be eligible for a tax credit up to \$500. Certain income limitations apply.
- Gifting limit increases from \$14,000 per person to \$15,000 per person starting in 2018.
- Minnesota's estate tax exemption amount increases from \$2.1 million to \$2.4 million in 2018.
- Retirement Plan Contributions – 401(k), 403(b), most 457 plans – increase from \$18,000 to \$18,500 in 2018. There are no changes to IRAs and Roth IRA contribution amounts.

UPCOMING EVENT: JANUARY 23, 2018

2018 Allodium Investment Forum – Thinking and Investing Like Warren Buffet

Dave Bromelkamp, Eric Hutchens and Anne Ward will provide helpful insights for investing wisely.
Save the date – January 23, 2018.

For more information about this event, please contact Ilona Avraamides at (612) 230-3711 or iavraamides@aicria.com.

WE APPRECIATE YOUR INTRODUCTIONS

To optimize our objectivity and avoid conflicts of interest, we are a fee-only registered investment advisor that is completely independent from banks, brokerage firms and other financial product providers. If you know someone who may be looking for this type of objective investment advice, please contact Dave Bromelkamp at 612-230-3702 or dbromelkamp@aicria.com to arrange a friendly, no-obligation introduction.

Steward is published quarterly by Allodium Investment Consultants. Please contact Ilona Avraamides at 612-230-3711 or iavraamides@aicria.com if you have any comments about this publication or wish to be added to or removed from our mailing list.

ALLODIUM[®]
INVESTMENT CONSULTANTS

© 2017 Allodium Investment Consultants

Allodium Investment Consultants, LLC (“Allodium”) is an SEC registered investment adviser with its principal place of business in the state of Minnesota. This newsletter is limited to the dissemination of general information pertaining to its investment advisory/management services and is not intended to provide investment, tax, legal or other advice. While taken from sources deemed to be accurate, the information contained herein is subject to change, and Allodium makes no representations about its accuracy, completeness or appropriateness for any given situation and disclaims any liability arising from use of or reliance on this information. Client satisfaction results and recognition by publications should not be construed as a guarantee of certain results when Allodium is engaged for investment advisory services, nor should it be construed as a current or past endorsement for Allodium by any of its clients. For additional information about Allodium, including fees and services, please request our disclosure statement as set forth on Form ADV using the contact information herein. Please read the disclosure statement carefully before you invest.