Sale or Loss Aversion…What is it?

Most studies suggest that investment losses are twice as psychologically powerful as gains. Loss aversion was first demonstrated by Amos Tversky and Daniel Kahneman. There are four primary benefits of applying loss aversion to investments teetering on the verge of risk:

- Advisors can act quickly when losses occur
- Investments and stock shares can be sold quickly in times of decline
- Documenting past losses can help prepare individuals for future risks
- Remedies, including diversification, focusing on the big picture, paying less attention to your account and the stock market can be applied to help save high-risk investments

To avoid losses from occurring, certain strategies should be practiced. **Mental accounting** helps individuals to organize, evaluate, and keep track of financial activities, including the source of the money and purpose for each account. For example, a retired banker from Colorado relocated to the Gulf Coast in Florida with $2 million in investments, specifically in technology. After suffering an 80% loss on his investments, he realized it was time to make some adjustments in his portfolio and applied mental accounting to correct his previous mistakes.

Because individuals often value various amounts of money in different ways, mental accounting can help assign different functions to each asset group, which affects consumption decisions and other behaviors pertaining to investment strategies.

The same conditions that trouble many individuals may be seen as an opportunity by others. Why not just look at this opportunity as a "Sale!".

It is true that people flock to sales to obtain something cheaper. It is also true that people sell their investments when they are falling and tend to buy them after they have risen a great deal. In fact, many indvidiuals buy when investments are marked up due to demand and sell when they are on sale. This odd

6143 S. Willow Drive, Suite 102• Greenwood Village, CO 80111
phone 303.468.2824 • fax 800.793.4866 • toll free 1.877.491.7514

phenomenon is referred to as "herd mentality" and comes from somewhere in the primeval part of our brain.

It is difficult to train oneself to overcome the fear and greed associated with making investments. This means having the ability to see pullbacks as a buying opportunity and high market valuations as a caution sign; however, this does not make it necessarily easy to turn off the portion of our brain that urges us to run. As Ted Schwartz said in a recent article, titled "Sale!"

> *"The pit of my stomach still churns when the market falls several hundred points and the "experts" are on TV predicting cataclysmic times ahead. Ultimately, I call on the rational part of my brain to override my churning stomach."*

Perhaps that is what we can best do for you -- act as the other side of your brain to avoid the emotional stomach churning sessions that market declines can often deliver.

Portfolio Notes

The foregoing comments represent the general investment analysis and economic views of the Advisor, and are provided solely for the purpose of information, instruction and discourse. Only comments in the Portfolio Notes section relate specifically to the Capstone Portfolios and the investment positions.

ETF PORTFOLIOS (Aggressive, Growth, Moderate, Conservative and Income)

Despite turmoil in the stock market, we have made little changes to the portfolio. We continue to own iShares Nasdaq Biotechnology (IBB) and SPDR S&P Pharmaceuticals (XPH). Over the last 12 months, the ETF portfolios (except the Growth and Income portfolios) are up, while the S&P 500 (a broad market index holding 500 of the largest companies) is down.

The Aggressive, Growth, Moderate, Conservative and Income portfolios returned 1.5%, -0.4%, 0.2%, 0.2%, and -0.7% over the past 12 months, respectively, after fees. This compares to the S&P 500 down 1.9% and the DOW (an index of 30 companies) ahead by 3.4%.

6143 S. Willow Drive, Suite 102• Greenwood Village, CO 80111
phone 303.468.2824 • fax 800.793.4866 • toll free 1.877.491.7514

Analyst Upgrades has lagged the broader S&P 500. Trending with lower returns since March, the Analyst Upgrade is down 7.0% for the last 12 months. Weakness continues to come from Frontier Communications (FTR) down 15%, and Sherwin Williams down 8%. Recent sales tallied gains and losses. Diamond Offshore (DO) dropped 11%, and Avago Technologies (AVGO) experienced a loss of 7%. Strength came from Reynolds American (RAI) up 15%, Lockheed Martin (LMT) with a gain of 11%, CMS Energy (CMS) rising by 7% and Tesoro Pete Corp (TSO) up 12%.

Analyst Momentum lost 1.8% net of fees versus the S&P 500 loss of 1.9% in the last 12 months. Drags to the portfolio include a decline in Delek (DK) by 18% and Avon Products (AVP) with a drop of 12%. There are very few recent gains from buying companies with improving return on capital that are selling at discount prices.

Focused Strength continued to give up gains and is now down by 13.2% for the past year. The volatility is extreme as the rotation in strength between asset classes is high. Half of the portfolio is in Vanguard REIT (VNQ), which is experiencing a drop of 10%. The other half remains in iShares Barclay 20-year bonds (TLT), falling 0.3%.

MaxBalanced is also down over the last 12 months. The holding of bonds has weakened the portfolio. To date, the portfolio is down 7.2% in the last 12 months versus the Dow Jones Global Moderate portfolio down 3.5%. The MaxBalanced portfolio is structured like a university endowment; investing in more than 12 asset classes. The idea behind this investment is that we cannot predict the market, nor can we accurately forecast how assets are measuring up at any given point.

As a whole, there is more red on my screen, meaning the holdings are down. Along with the declines, there is also green, meaning that some investments are experiencing a gain. WisdomTree Emerging Markets SmallCap Dividend (DGS) is suffering the greatest loss, with a decline of 28%. This is followed by iShares Mexico Index Fund (EWW) with a fall of 25%, and Guggenheim Multi-Asset Income (CVY) down 23%. The gains come from SPDR Regional Banks (KRE) up 2% and Consumer Staples with an advance of 3%.

Bond ETF decreased 0.4% in the last 12 months, compared to the Barclays Aggregate Bond

6143 S. Willow Drive, Suite 102• Greenwood Village, CO 80111
phone 303.468.2824 • fax 800.793.4866 • toll free 1.877.491.7514

Index, which was up 2.1%. Of the 13 holdings, 7 indicated losses, and the 6 with gains are just ever so slight. The two largest losses are from emerging market bonds (EMB) and high yield bonds (HYG), down 9% and 8% respectively. The greatest gain is led by iShares Barclays 20-year plus (TLT) up 6%.

Please feel free to pass "The Portfolio Reporter" to interested friends and family members. For more information about your investments, please contact your financial professional.

The opinions expressed here are based on the author's views and should not be construed as financial advice. Model results do not represent actual trading and may not reflect the impact that material economic and market factors might have on the advisor's decision-making if the advisor were actually managing a client's money. Past performance is no guarantee of future performance. There can be no assurance that a client's investment objective will be achieved or that a client will not lose a portion or all of his or her investment. Please contact Capstone directly for a list of the recommendations provided over the last year. Investing outside the United States involves additional risks, such as currency fluctuations, periods of illiquidity and price volatility. These risks may be heightened in connection with investments in developing countries.

MONTHLY CONFERENCE CALL

Our next monthly conference call will occur Thursday, September 17th at 11:00 a.m. Mountain Time (1 p.m. EST).

To *listen* to the Live Call, below is the information:
Phone Number: 866-740-1260
Access Code: 4682824

To *view* the slides during the Live Call, you will need Internet access and a phone: *
Website: www.readytalk.com
Access Code: 4682824
(Enter 4682824 in the field under "PARTICIPANT, Join a Conference")

***You must also dial into the phone number above to hear the live conference call.**

6143 S. Willow Drive, Suite 102• Greenwood Village, CO 80111
phone 303.468.2824 • fax 800.793.4866 • toll free 1.877.491.7514