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A Registered Investment Advisory Firm

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It's More Like Brain Surgery Than You Think

One facet of the investment environment that never changes is change. The economy moves up and down and sideways, leaving some investors with high returns and others with losses. Investment strategies and products evolve, forcing investors to adapt to new concepts and a new vocabulary. Technology brings intensive data analysis and light speed communication to markets, confounding rather than clarifying investment decisions.

The only facet of investing seemingly immune to change is how the human brain makes investment decisions.

We are all familiar with the concept that the hemispheres of the brain function differently. The left brain is associated with logical thought, while the right brain is intuitive and creative. Newer research rejects the idea that one side can dominate the other, and proves that both functions communicate in decision-making. While we analyze the facts, we are also intuiting possibilities. There is one more area of the brain that gets involved...the amygdala nuclei, so-called lizard brain, where we store emotional memories and habitual biases and probably risk tolerance tendencies.

Think back over your investment history. Have you ever made a decision purely on rationality? Or, when you trusted your gut, was there not logic to it in the background? Even more likely, with these three brain parts competing with each other, do you really make the best investment decisions or simply choose one among several options with reservations? You cannot force intuition and emotion out of your brain because you want to rely on reason alone. And where does it say financial markets are rational? So how can you bring these decision factors into balance?

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Let us start with the wisdom of ancient Greeks who carved a two-word sentence in a stone at Delphi; Know thyself. But let us add a corollary that we carve in stone here at DH Financial; Know thyself and thy clients. We believe that integrating emotion, intuition, and reason is fundamental to sound financial decisions for investors and advisors.

Our reason tells us to scrupulously research and objectively interpret investment data to assure you make informed decisions. Intuition reminds us to overcome any over-confidence and over-optimism. Past experience and success are not reliable indicators of future events. And while the goal of family financial security and harmony is universal, all clients have unique stories and aspirations that we connect with emotionally and frame our advice accordingly.

If the brain sends mixed messages in the decision process, the cycle of emotions after your decisions can feel like the lizard brain on steroids. Human nature prefers investments that only go up, but if markets only go up, our capitalist model would collapse. Up-and-down cycles are built-in, and we understand up-and-down feelings you may go through.

First come the emotions of the ascent.

Optimism- This investment is sure to succeed.

Excitement- How much higher can it go?

Thrill- Hey, I am really smart.

Euphoria- It is almost too good to be true.

Here is the point of greatest financial risk...when investors believe there is no risk of change. When the change comes they do not anticipate or react effectively, and the emotional descent begins.

Anxiety- What is the worst that could happen?

Denial- This is only a temporary setback and I am a long term investor.

Fear- What if it does not turn around?

Desperation- How bad is it going to be?

Panic- I do not know what to do.

Capitulation- How could I have been so wrong?

Despondency- I'll never do this again.

Here is the point of greatest financial opportunity...when everyone wants to get out. For those who anticipate and react to change effectively, a new ascent begins.

Depression- Am I supposed to learn a lesson from this experience?

Hope- I am going to stay in the game.

Relief- I am glad I stayed in the game.

Optimism- I see no reason this new investment should not succeed.

Imagine going through this cycle of emotions on your own. Some people cannot make it past Depression. Worse, imagine that during the descent, your financial advisor does not return your calls, or sends an email to remind you that he explained the risks when you made your decision.

Understanding the facets of behavioral finance and cycle of investor emotions gives you two reasons to establish a great lasting relationship with a financial advisor. Great, because your advisor really knows who you are, appreciates how you think, and pays close attention.

First, the advisor will help you develop an investment diversification plan suitable to your goals and circumstances. A plan that integrates your unique reasoning, intuition, and emotions, instead of ignoring them.

Second, you can depend on your advisor to manage change with you and flatten the emotional roller-coaster ride most investors have to endure.

Best Regards,

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