MONONGAHELA CAPITAL MANAGEMENT

PERCEPTIONS

2nd Quarter, June 30, 2016			
	6/30/2016	**% Change 2nd Quarter**	**% Change Year to date**
Dow Jones Industrials	17,929.99	2.07 % *	4.31 % *
S & P 500	2,098.86	2.46 % *	3.84 % *
Russell 2000	1,151.92	3.79 % *	2.22 % *
BC Aggregate BD Index		2.21 %	5.31 %
10 YR Treasury Yield	1.492 %		
30 YR Treasury Yield	2.300 %		

* *Includes reinvested dividends*

Myopic Loss Aversion

While moving research boxes to the third floor of our Mercer Street offices, we re-read an interesting paper whose lead author was Richard H. Thaler of the University of Chicago in *The Quarterly Journal of Economics, May 1997.*[1] In the paper, Thayer discussed the risk that too much information (feedback) may lead to more frequent investment decisions. In Thayer's research, the resulting increase in activity significantly lowered the rate of return. Thaler went on to define Myopic Loss Aversion as "the combination of a greater sensitivity to losses than to gains and a tendency to evaluate outcomes frequently." He theorized that providing investors with frequent feedback about their outcome would "encourage their worst tendencies."

Thaler's experiment simulated a series of investment decisions. Portfolio managers were presented with a choice to allocate funds between two investments, Fund A and Fund B. Fund A represented a balanced growth fund while Fund B was structured as a bond portfolio. In the experiment, the simulated portfolio would be managed for 25 years. The key variable in the experiment was how often the manager would receive feedback on the portfolio's performance. Each time the manager received feedback on performance, the manager was allowed to change the portfolio allocation. The options for information and change were every month, every year or every five years.

Intuitively, one would posit that more frequent information would result in better performance. Thaler's research found the opposite to be true. The managers with monthly return information and the freedom to re-allocate monthly performed the worst. Over the 25 year simulated history, subjects who received performance information only once every

five years earned more than twice as much as those who received monthly reports. The presentation of short term information and the option of more frequent allocation choices created an illusion of knowledge and ultimately lowered returns.

This research experiment was reported in 1997, before the advent of Google, Facebook and Twitter. The flow of information has increased exponentially since then as has the availability of low price trading platforms. The siren call of seductive financial messaging 24/7 is a recipe for lower returns. During the last two weeks of the quarter, we received numerous inquiries as to what portfolio adjustments we should make in anticipation of, or reaction to the Brexit referendum. The Brexit consequences were vigorously and constantly debated in the financial media but at the end of the day, we made NO adjustment related to the Brexit decision. While the decision on Brexit was a significant news event, changing portfolios and long term plans in reaction to the referendum would have lowered returns.

As you know, we are bottom-up value investors. Our research efforts are focused on determining whether a single asset is properly priced. The macro environment, while important, is viewed through the lens of its impact on individual securities. The discipline of fundamental analysis helps minimize myopic loss aversion.

[1]Richard H. Thaler et al., "The Effect of Myopia and Loss Aversion on Risk Taking: An Experimental Test," *The Quarterly Journal of Economics, May 1997.*