

Evidence-Based Investment Insights

You, the Market and the Prices You Pay

When it comes to investing (or anything in life worth doing well) it helps to know what you're facing. In this case, that's "the market." How do you achieve every investor's dream of buying low and selling high in a crowd of highly resourceful and competitive players? The answer is to play *with* the crowd rather than against the crowd by understanding how market pricing occurs.

The Market: A Working Definition

Technically, "the market" is a plural, not a singular place. There are markets for trading stocks, bonds, sectors, commodities, real estate and more, in the U.S. and around the globe. For now, you can think of these markets as a single place, where opposing players are competing against one another to buy low and sell high.

Granted, this "single place" is huge, representing an enormous crowd of participants who are individually AND collectively helping to set fair prices every day. That's where things get interesting.

Group Intelligence: We Know More Than You and I

Before the academic evidence showed us otherwise, it was commonly assumed that the best way to make money in what seemed like an ungoverned market was by outwitting others at forecasting future prices and trading accordingly.

Unfortunately for those who are still trying to operate by this outdated strategy, a simple jar of jelly beans illustrates why it's an inherently flawed approach. Academia has revealed that the market is not so ungoverned after all. Yes, it's chaotic, messy and unpredictable when viewed up close. But it's also subject to a number of important forces over the long run.

One of these forces is **group intelligence**. The term refers to the notion that, at least on questions of fact, groups are better at consistently arriving at accurate answers than even the smartest individuals in that same group . . . with a caveat: *each participant must be free to think independently, as is the case in our free markets.* (Otherwise peer pressure can taint the results.)

Take those jelly beans, for example. In one experiment, 56 students guessed how many jelly beans were in a jar that held 850 beans. The group's guess — i.e., the aggregated average of the students'



individual guesses — came relatively close at 871. Only one student in the class did better than that. Similarly structured experiments have been repeated under various conditions; time and again the group consensus was among the most reliable counts.

Now apply group wisdom to the market's multitude of daily trades. Each trade may be spot on or wildly off from a "fair" price, but the aggregate average incorporates all known information contributed by the intelligent, the ignorant, the lucky and the lackluster. Thus the current prices set by the market are expected to yield the closest estimate for guiding one's next trades. It's not perfect, but it's assumed to represent the most reliable estimate in an imperfect world.

Your Take-Home

Understanding group intelligence and how it governs efficient market pricing is a first step in more consistently buying low and selling high in free capital markets. Instead of believing the discredited notion that you can regularly outguess the market's collective wisdom, you are better off concluding that the market is doing a better job than you can at forecasting prices. With this understanding of evidence-based investing, your job then becomes learning how to focus on the things that you can control to more efficiently capture the returns that are being delivered.

David Bromelkamp
President and CEO

Insanity: doing the same thing over and over again and expecting different results.

Albert Einstein

Headlines

- Guests enjoyed a wonderful evening on the Mississippi River for our Client Appreciation Event on August 18th.
- Sue Johnson, our former Client Service Associate, has successfully transitioned into retirement and is taking care of her grandson after serving Allodium since its founding.
- The Wall Street Journal quoted Bryan Polley in an article on August 21st about passive and indexed investing.
- Dave Bromelkamp will be presenting at the Kansas Association of Community Foundations annual conference on September 29th.
- Allodium was pleased to welcome one new client in the second quarter.
- Our office will be closed on November 27th and 28th for the Thanksgiving Holiday.

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



FINANCIAL PLANNING TIP

Don't hit the panic button!

It may start with a 911 call, a quiet discussion with a doctor, or a lingering concern regarding persistent pain. Whatever the fanfare of the initial realization, we all know someone who has come face to face with an acute or terminal illness.

In these moments, we often feel concern and sympathy. If it is someone extremely close, there is often fear of the host of unknowns that pervade our thoughts.

But it is crucial to not hit the panic button. Instead, proactive planning is of utmost importance. Getting an advanced health care directive in place should be a top priority, as only about one-third of adults have written instructions expressing their end-of-life wishes.

While financial matters are often last on the list, addressing these aspects of one's life can be crucial, allowing focus to be on much needed care and comfort. Allodium has collaborated with advanced planning experts to develop a four step checklist that addresses cash flow needs, available resources, tax deductions and critical estate planning questions.

This checklist is available at no charge, and we also offer advanced planning meetings for clients. Give us a call to discuss how we can help.



Mark Your Calendars

Wealth Management Workshop

DATE: Tuesday, September 30th, 2014 **TIME:** 4:00 p.m.

Allodium is hosting a workshop for clients and associates titled **"Savvy Estate Planning: An Expert's View on Protecting and Transferring Your Wealth"**. Guest speaker **Stuart Bear** from the law firm of Chestnut Cambronne will help attendees learn more about estate planning and the ways in which it can influence their families, finances and personal well-being.

For more information or to RSVP, please contact Tyler Chapman at 612-230-3705 or tchapman@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 Tyler Chapman at 612-230-3705 or tchapman@aicria.com if you have any comments about this publication or would like to be added to or removed from our mailing list.



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