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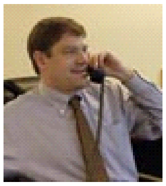

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Christmas classics and Errant Lumps of Coal

About twenty years ago, there was an anti-narcotics TV spot with a man holding up an egg: "This is your brain." He cracks the egg into a pan and commences frying it to cinders: "This is your brain on drugs… Any questions?" Compelling stuff, whether or not it won the War on Drugs, but I want to talk about your brain "on Christmas" (in the holiday "hype" sense) and by extension how emotions can vie against reason in investing, potentially turning the flame too high under investors' decisions and "frying" their portfolios.

Different structures within our brains are primed for different stimuli and they can promote conflicting responses. The emotional center of the brain, the limbic system, craves instant gratification and favors whatever promises to deliver it. Show the limbic system a chocolate marshmallow Santa and a plate of vegetables, and it will grunt "Must eat candy!" In contrast, the parietal system is the sober functionary, mandated by the frontal cortex to calculate the dental and caloric downsides of one choice against the salubrious nutrients of the other: "In the long run, vegetables will prove to have been the better choice." A spoilsport voice, perhaps, but analytically sound.

What's this got to do with the holidays? The mall's air of limbic mania becomes ever more palpable as we get deeper into December. Rationality can take a back seat, with real consequences (shoppers spending twice what they'd budgeted) and incivilities unthinkable any other time of year (soccer moms practically clothes-lining one another to get to the last Tickle Me Elmo doll). Fear and greed, Keynes' "animal spirits" of the marketplace, play out in 3-D as parents overbuy to avoid disappointing their kids, and even adults succumb to the "gimmes."

What's this got to do with investing? Evolutionarily, Keynes was right when he referred to "animal" spirits. The limbic core, that reptilian walnut at the center of our skulls, can influence choices without our even being aware of it. This was a good thing, millennia ago. When a saber-toothed tiger hove into view of your ancestor, his limbic system caused him to bolt without hesitation, saving him – and thus you – from any fronto-parietal deliberation. Similarly, a "greedy" maximizing of caloric intake was a good thing for your ancestor. But this basic hardwiring doesn't help much in modern markets. Greed (for easy gains) and fear (of being left behind) can alike draw us into market bubbles and their inevitable bursting. At the same time, a fear of assets with beaten down prices can blind us to their intrinsic value; we grow queasy at the prospect of doing what others won't and end up doubting not our feelings ("run!") but what's indicated by our analysis ("buy low").

Our goal at Allen Trust and Allen Capital is to modulate between the influences of emotion and analysis for our clients, to be your portfolios' frontal cortex, if you will. We're neither the limbic six-year-old who tears through every gift as fast as the wrapping can come off, nor the parietally dominated spinster aunt who always gave you socks. Rather we try to focus on what is both satisfying and rewarding, and on what will last.

We restrain limbic plunges into the hottest stocks of late (this year's "must have" toys), or companies more shiny than sound (stuff that breaks before the first bar of *Auld Lange Syne*), or highflying firms ever needy for more capital to sustain them (the battery hogs). At the same time, we recognize that there's more to life than, well, socks… most portfolios need more than bank cds to accomplish what they're supposed to. And though we will encourage appropriate time horizons and mandate good analysis, we also know that the market won't always abide by or reward logic alone, and that sound calculations, though prerequisite, are not guarantors of the future, least of all in the short run.

So we tend toward adaptability, quality and durability… Christmas Classics like the Flexible Flyer sled (Amgen), the chunky metal Tonka truck (Conoco Phillips), the chemistry set (Dow Chemical), the Raggedy Ann doll (Kimberly Clark), the Monopoly board (Microsoft), and that make-anything failsafe, Legos (General Electric). While these aren't exactly investment "chocolate," you don't have to pay a greed premium to buy them.

We're also not above sifting for discarded lumps of coal, those yearend cast-offs whose recent poor performance evokes an elemental fear or revulsion among others. While they may not shine into diamonds, quite, they may yet throw off a cozy heat, and not at the cost of a cool head or "fried" portfolio.

We here at Allen Trust and Allen Capital wish you health, peace and good cheer, and not just cool heads, but warm hearts as well. Happy holidays!

Bill Harris