Rethinking Advisers as Behavioral Coaches

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Advising is so much more than this

Based in the USA – these are some of the leading academics involved with the research.

Morningstar's Behavioral Science Advisory Board

John Besheear

Hal Hershfield UCLA

John Lynch U. Colorado

Katherine Milkman Wharton

Terrance Odean UC Berkeley

Antoinette Schoar MIT

Abigail Sussman Chicago Booth

Jon Zinman Dartmouth

Leading behavioural researchers from around the country, working with us on original research for peer-reviewed academic publication

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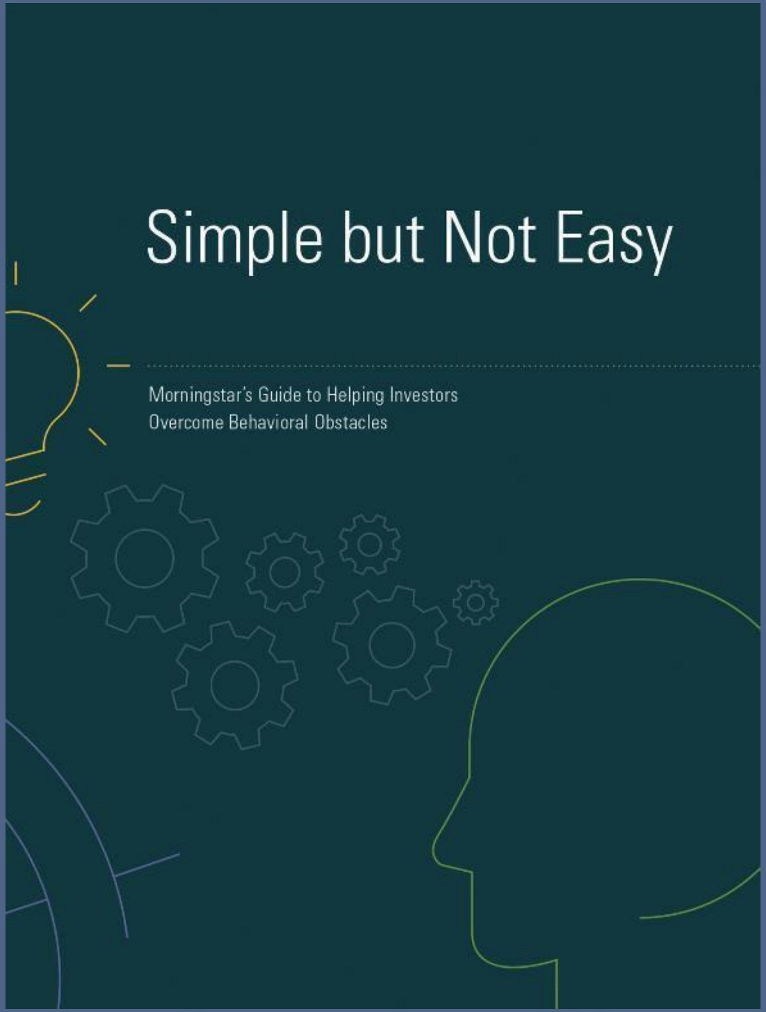
See our guide to applying behavioral science: œSimple But Not EasyŔ



http://www.morningstar.com/lp/advisor-toolkit

You’ve developed a solid plan together

Investors are, in good times, calm, collected and invested for the long term…………

But something happens

Events create mini panic …. And sometimes throw investors off course, which is a basic error.

And they want you to take action!

Clients want Advisors to take action, which is often the wrong action to take …. Standstill, pause to understand the position and remember the plan, the time horizon and the main goal… humans are programmed for danger. This stress from life threatening danger at our human beginning.

See: Bar-Eli et al. (2007)

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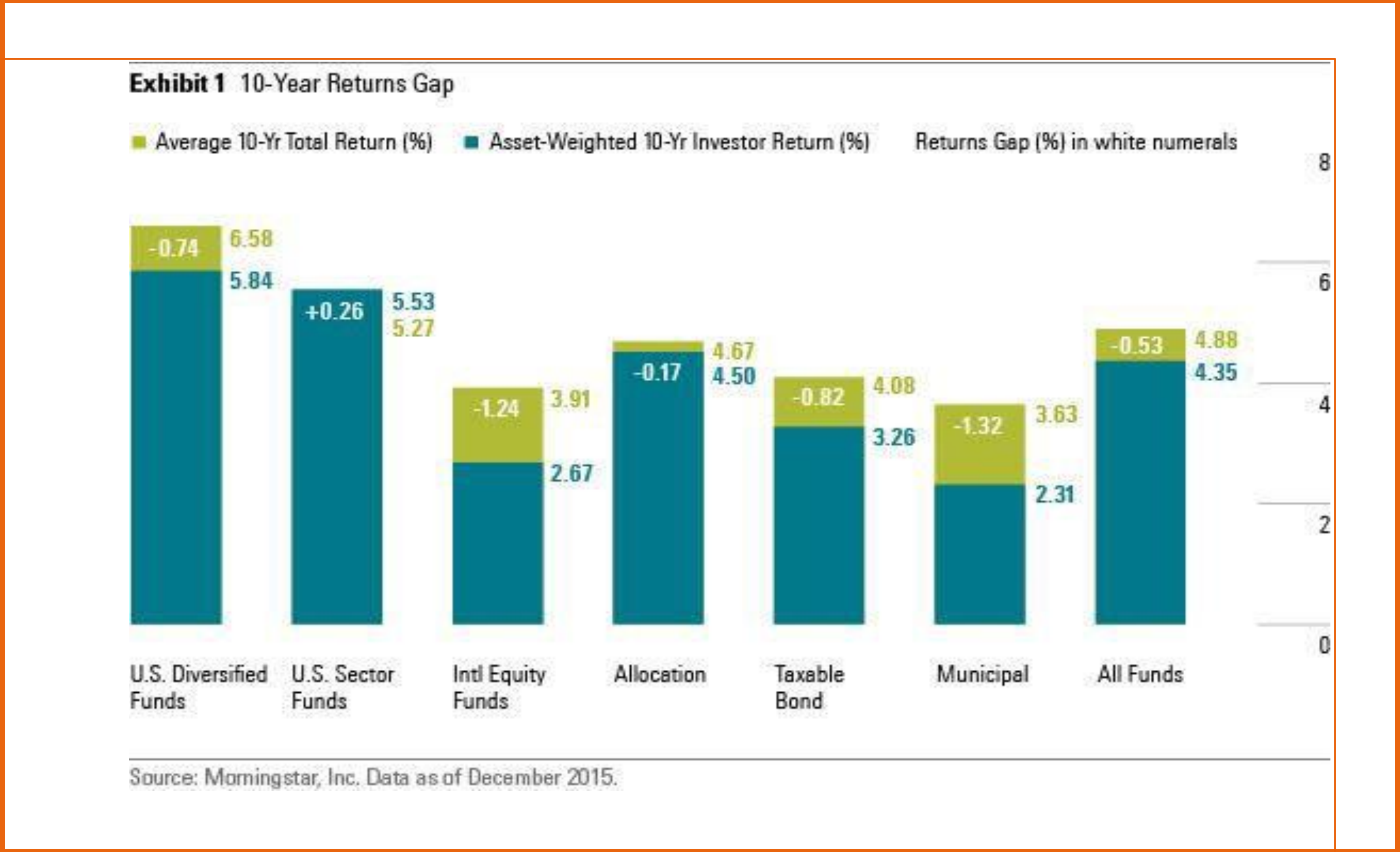
The advisor’s greatest value: behavioral coaching



Mind the (Behavior) Gap

Investors buy and sell at the wrong time often……….

See: Bennyhoff and Kinniry (2013) re Advisor’s Alpha; Kinnel (2013) re behavior gap

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How can you help investors stay with calm, collected, in-it-for-the-long-term investing?

We must always re-affirm that if a client is invested, they are in-it-for-the-long-term when investing.

The present is easy to focus on – we find it less easy to focus on the future

Biases at work: Present Bias (Temporal Myopia)

Tip 1: Imagine the Future

Future Visualization Exercises:

➢Where do you want to be living in 10 years?

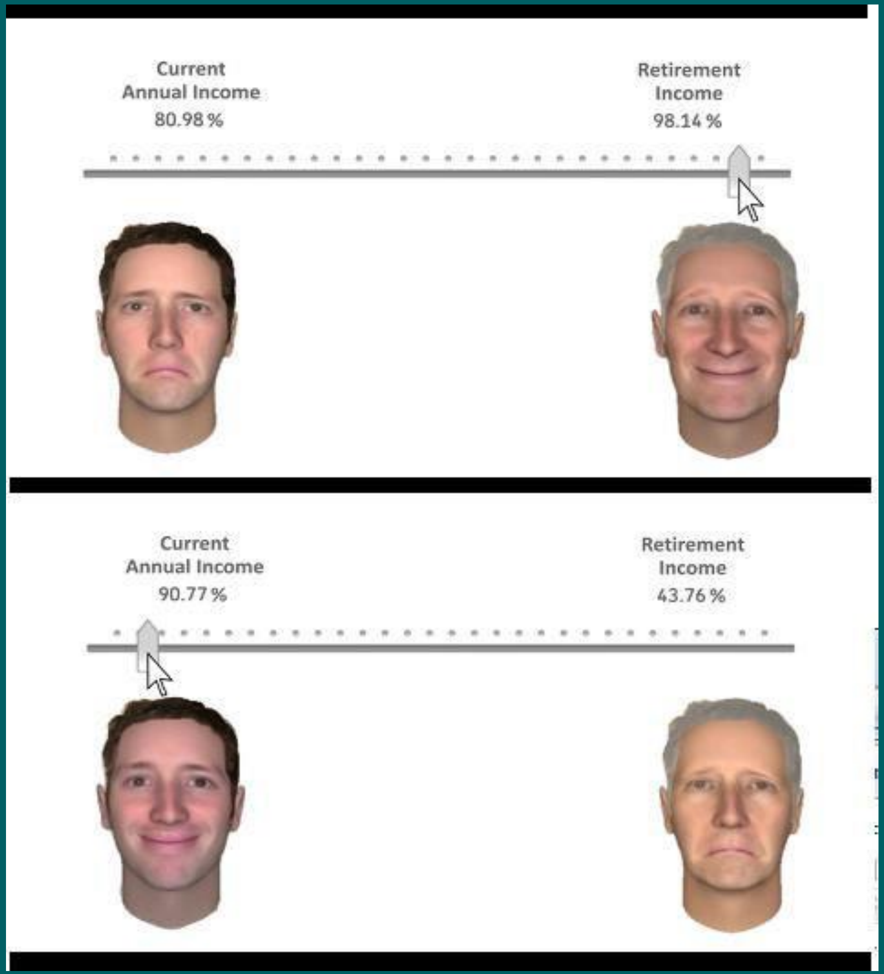
➢How will you spend your days?
Working, traveling, parenting?

➢Imagine a day from waking to sleeping, where do you go? What do you do?

Try to imagine your future…….

Tip 2: Age Progression

Hal Hershfield
UCLA



A study conducted by Hal Hershield of UCLA has concluded that Age Progression motivates financial planning.

It is commonly understood that people/investors prefer to avoid losses than acquiring gains. This must be understood in the context of time and longer term goals.

Biases at work: Loss aversion

People strongly prefer to avoid losses than acquiring gains

See Kahneman and Tversky (1979)

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But there are also biases at work. For example: Descriptive norms

Other people send a strong signal of what we should do.

Which can create a "herd mentality".

If you do what others do, you get what others get ……..

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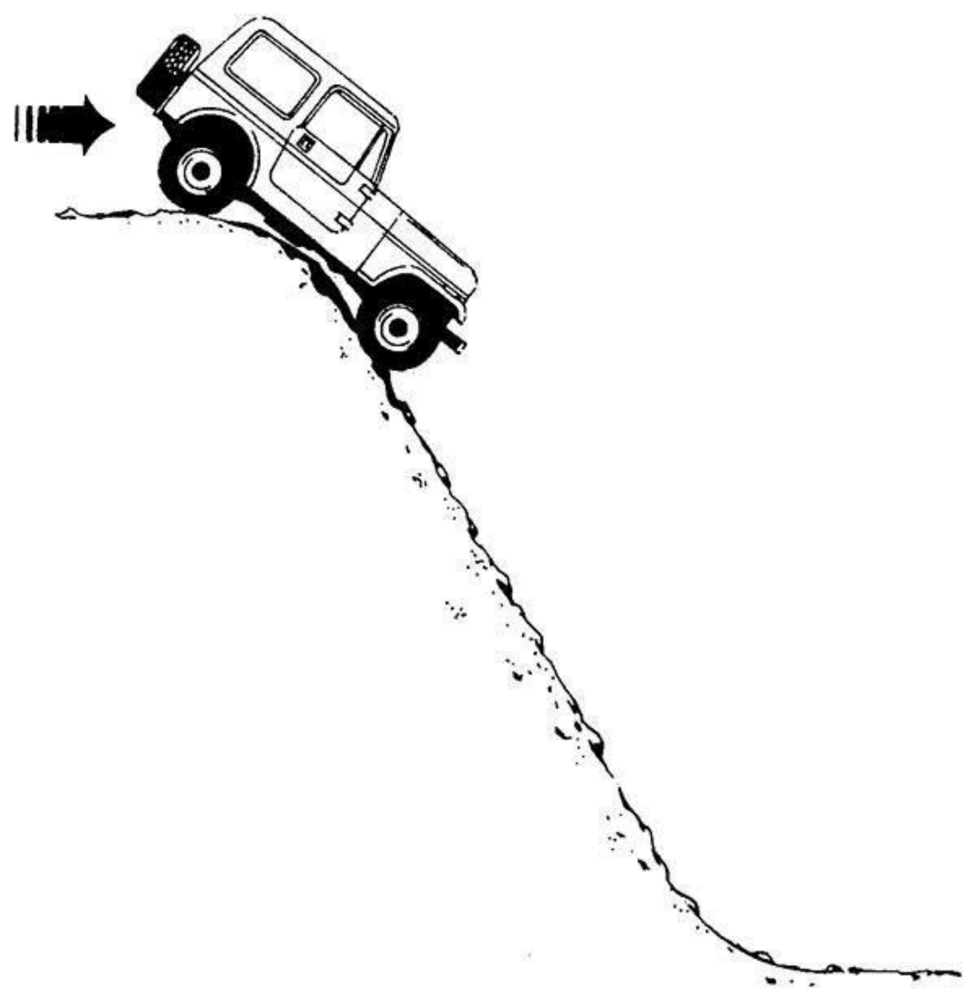
Other biases at work: Recency Bias



We look for the risk patterns, where we need to focus on the journey………

Recent experiences forebode something worse coming

Tip 1: Change the market narrative

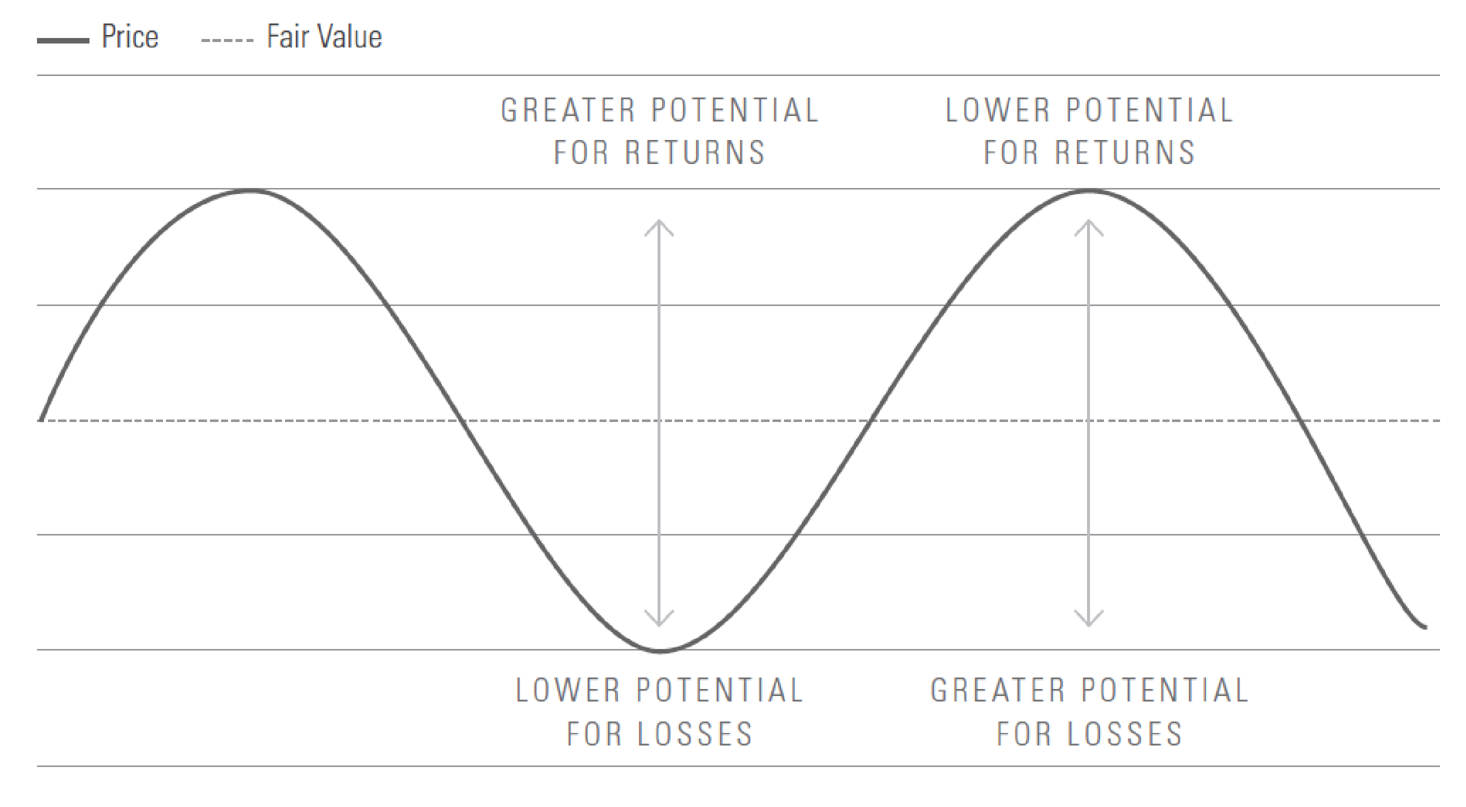


Image from Morningstar Investment Management

Tip 3: Help prepare them for the inevitable

"Experienced" investors are prepared for short to medium term losses. Investment falls in value are inevitable – so investors should get "prepared" and stay the "investment course".

See: Ashraf et al. (2006)

Let’s do this together:

The Personal Commitment Letter

To my future self,

I know you want to move your money right now. The market is going crazy. I am writing to remind you that even though it is tempting, what you really want to do is stay the course.

You have planned well, and you can handle the storm. Remember how you felt when you sat down with ______________________________ and talked about the reasons for choosing your strategy.

Ride it out.

Sincerely,

____

Date _______________

Page 23 “ Letter to your future self"

Very powerful – if not cheesy – some Advisers in the USA use this.

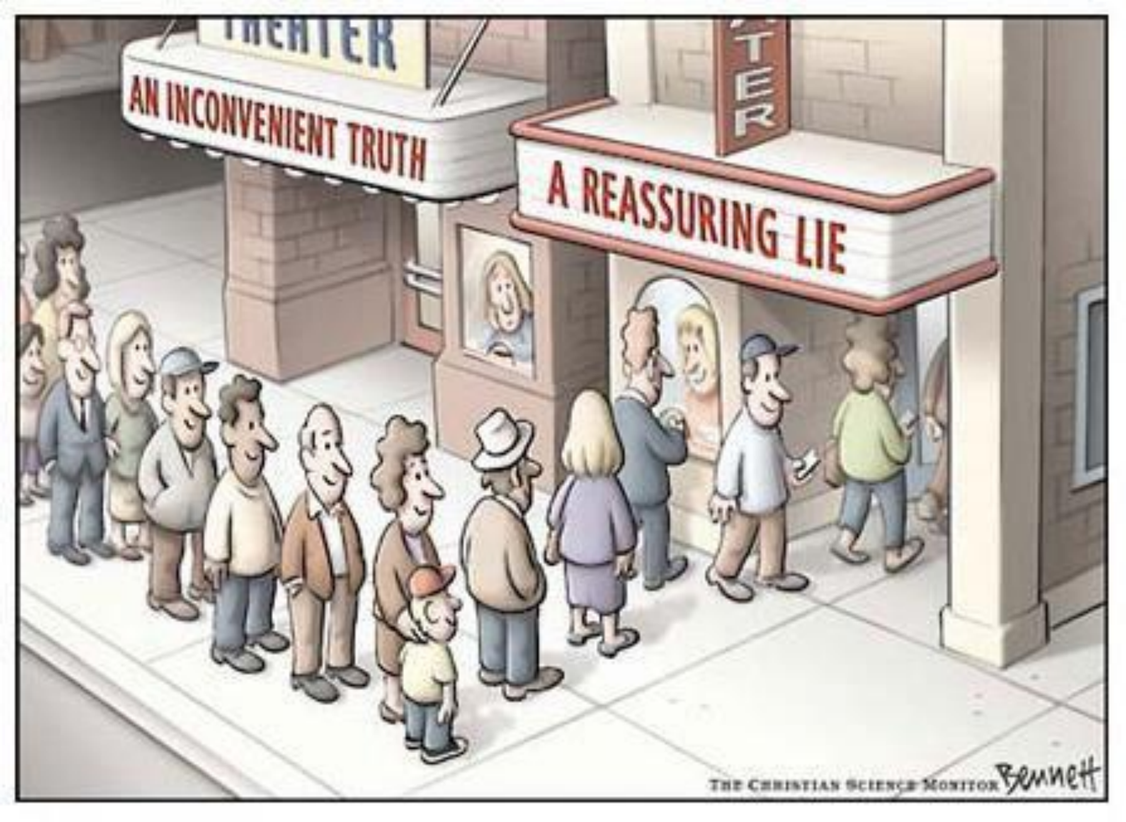
Biases at work: Hot-Hand Fallacy

Imagine this…

See Tversky et al. (1985)

Biases at work: Confirmation Bias

We all search for confirmation bias – my mate down the pub said ………



We seek out, and remember, information that supports us

See Nickerson (1998)

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Biases at work: Overconfidence Bias

70% of drivers think they are great drivers!

We over estimate our abilities and each believe we’re “above average”

Tip 1: Education about psychology can help

A simple education in psychology can help. An understanding of investment outcomes and the investment strategy is suitable to the investor's needs is the start. Loss aversion will always develop – this is built into our DNA.

See page 6,Why we shoot ourselv es in the foot

See Perttula (2010)

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Tip 3: Assess your client's financial personality type

Better understand how your clients think and how that affects their finances

See: Assessing a Client's Financial Type
Pages 18-20 of Simple But Not Easy

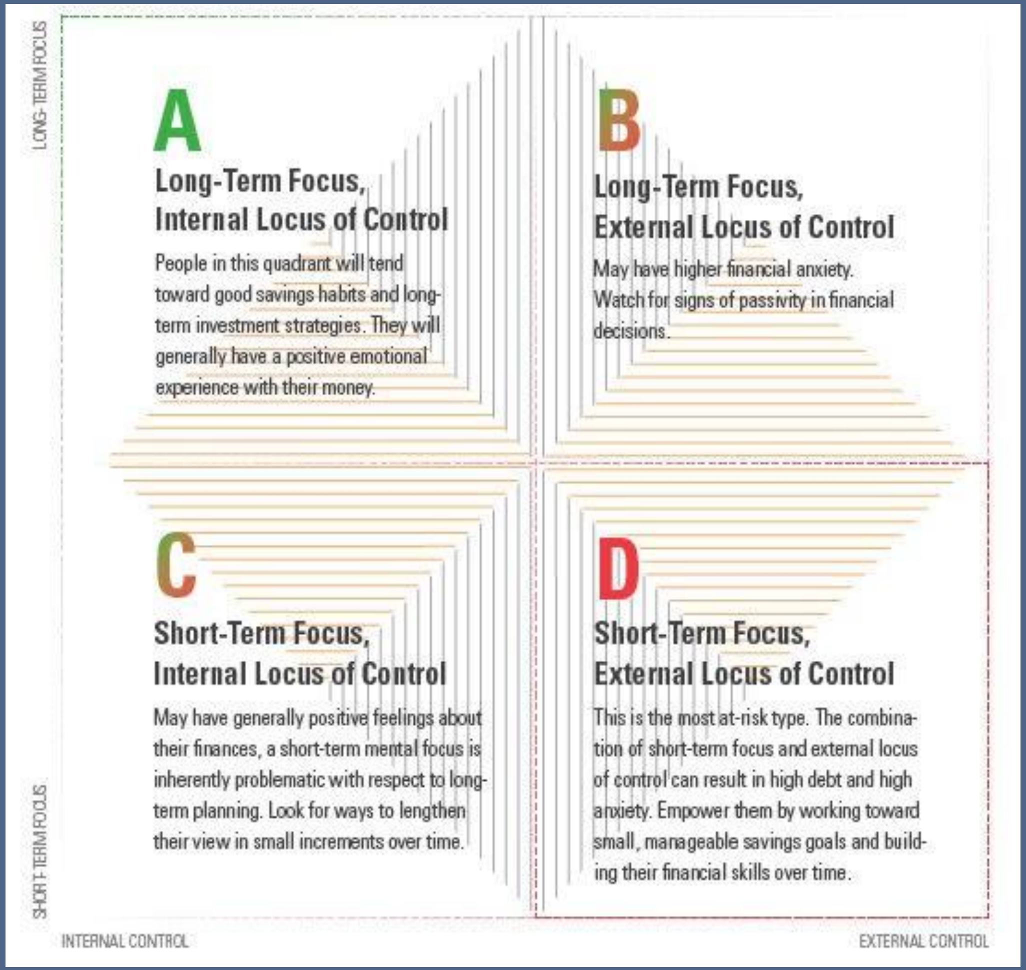
Time Perception

Locus of Control

Emotional Drivers

See: Liersch (2015); Kinnel (2013); Barber & Odean (2000); Benartzi & Thaler (2007); Newcomb & Wendel (2016)

Three psychological axes



The three axes of the Financial Personality Matrix:

Locus of Control, Time Horizon, and Emotional Valence.

The pillars of investing knew intuitively about psychology …

œThe investor’s chief problem—
and even his worst enemy—is
likely to be himself.Ŕ

-Benjamin Graham (1894-
1976)

He is regarded as one of the fathers of investing and behavioural sciences.

Valuation-driven investing is about psychology

See page 31,"Resources to learn more’

Investors’ views, be it “bullish” or as a “bear” regularly conflict so it’s imperative that an investment plan stays the course, with “adjustments” to steer through the rough ride ….