FOUR WAYS TO ENHANCE YOUR PRACTICE WITH BEHAVIORAL FINANCE

Redefining Behavioral Finance

REDEFINING BEHAVIORAL FINANCE

Despite the countless articles, research studies, and books published on behavioral finance and its impact on financial advice, very few writings provide actionable insights for how to incorporate these concepts into client relationships or the fundamentals of investing.

Most of the content published on this topic explains what behavioral finance is, its significance, and the definitions of various biases that plague investors.

As a result, advisors are left with interesting anecdotes or pop-psychology musings when what is really needed is a multi-step solution of coaching, investment selection, and repeated communication to fully address the ingrained instincts that drive "irrational" investor behavior.

Here are four steps advisors can take right now to implement behavioral finance concepts

1. Make coaching the center of your client relationship philosophy.

We believe by readjusting your value proposition around behavioral coaching you can make it the core of your advisory practice, effectively differentiating you as an advisor. By centering your practice around behavioral coaching, you can base your client conversations on behavioral lessons and applications more holistically while building and strengthening trust. This will keep the importance of behavioral coaching top of mind for investors, instead of reducing it to an after-thought when the market misbehaves.

Actionable Steps:

- Adjust your website to reflect the behavioral coaching as your core value to clients and why.
- Focus client conversations around goals, long-term returns, and behavioral bias education.
- Emphasize how behavioral coaching helps them be better investors through daily social media engagement, monthly email newsletters, and regular seminars.

2. Construct portfolios with investment solutions that seek to provide a calmer investment experience.

Due to behavioral biases, many investors have a difficult time sticking to a simple broadly diversified portfolio. Investors tend to chase markets, compare with peers, buy high and sell low, give up on stocks at exactly the wrong time, and so on. Improving the quality of the investment experience should be the goal of every financial advisor.

Best ways to do this involve:

- Diversify with truly non-correlated strategies and investments, such as options-based strategies
- Build in buy low, sell high strategies and processes
- Incorporate strategies that systematically seek to reduce big losses
- Select money managers that seek to do one or all of the above

3. Emphasize long-term, goals-based investing with aligned performance metrics.

The industry depends on short-term trailing returns that focus on gains—this continuously reinforces the demand for gains and encourages the preoccupation with short-term performance. There are other metrics that provide a more goals-based approach to measuring risk, returns, and the trade-off between the two.

Metrics and tools that evaluate the risk, measure long-term consistency, and seek to provide better understanding of the long-term investment journey are necessary for changing the way you and your clients view and discuss investments. Metrics like the pain index, pain ratio, and rolling returns are a few that you can begin incorporating.

4. Explain to clients what's worth worrying about and what's not.

Combating the daily deluge of investment and economic news can be difficult. Communicating to clients what's worth paying attention to and what's better left behind can help strengthen trust.

- Explain why corrections are not worth panicking about
- Remind investors the risks of timing the market and the gains they can miss out on if they're not always invested
- Refer to previous "news-worthy" market events that didn't leave much of an impact and explain why embracing risk is key for a long-term investing strategy

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Investors seek out advisors because they want the expertise and someone to help manage their emotions when it comes to money management. With the rise of robo-advisors, the human factor will be more important than ever. Redefining the value proposition beyond a provider of financial advice to include behavioral coaching elevates advisors, reminds investors why they want an advisor in the first place, and helps align their practice with the fiduciary standard. Effecting fundamental changes to portfolio construction and investment products that address behavioral challenges is paramount for the long-term success of any financial plan.

The media isn't helping. The industry isn't helping. Human nature isn't helping. In the face of these challenges, it's not enough to merely educate. Coaching needs to be an integral part of your advisory business from the start of the client relationship and carried throughout your communications and demonstrated in portfolio construction.

Better portfolio construction and consistent behavioral coaching that seek to minimize the biased investor mindset are essential for successfully incorporating the behavioral finance concepts into your practice.

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