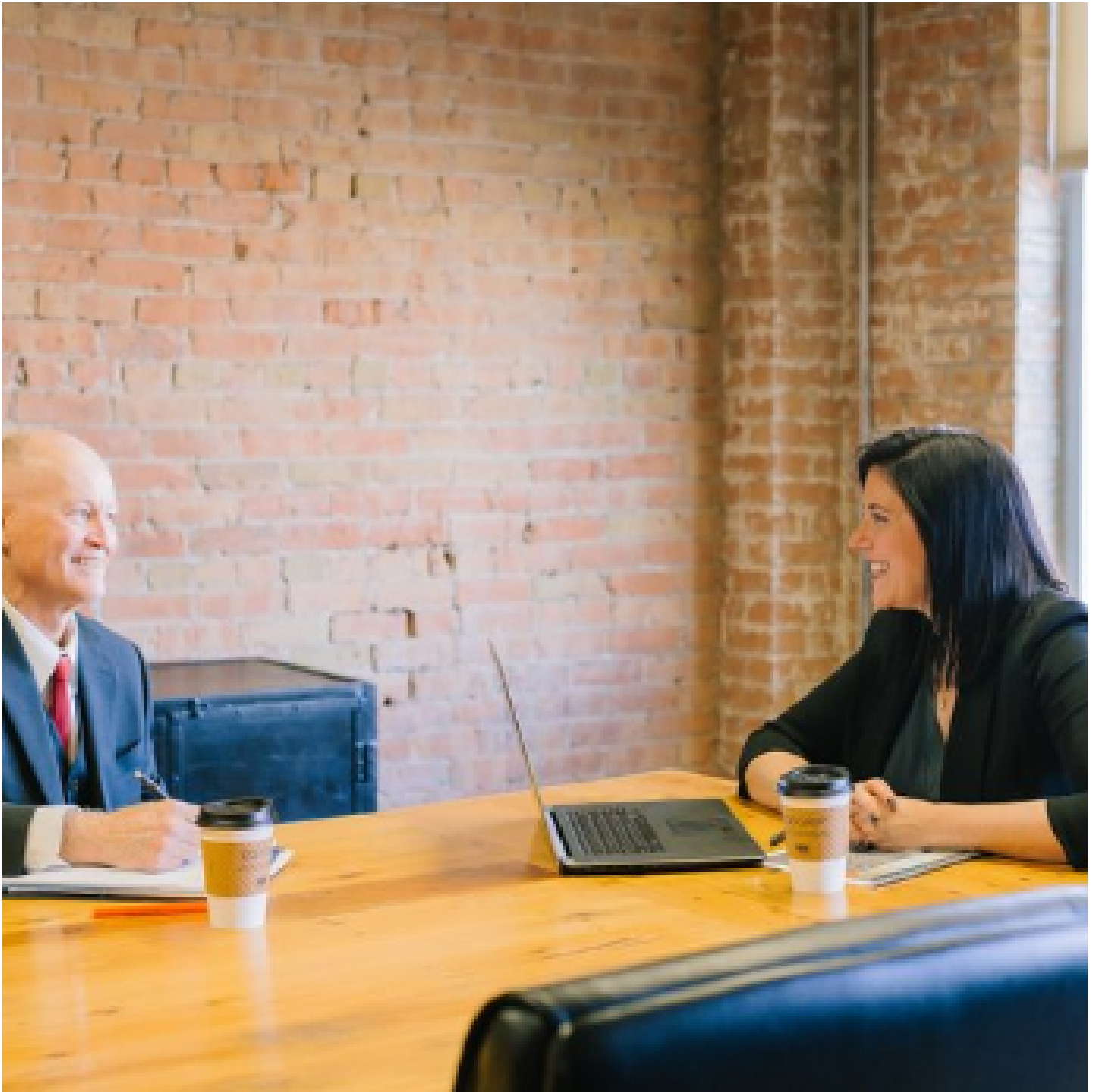


The Art of Behavior Coaching: How Financial Advisors Unlock Client Potential



Title: The Art of Behavioral Coaching: How Financial Advisors Unlock Client Potential

Introduction:

Behavioral coaching is a crucial aspect of the services provided by financial advisors, yet it is often overlooked when considering the value of financial advice. By understanding and addressing the psychological factors that influence investor decision-making, financial advisors can guide their clients through the complexities of investing, helping them avoid common pitfalls and achieve their financial goals. This article will delve into the importance of behavioral coaching, provide specific examples of its impact on clients, and discuss the quantitative benefits, measured in basis points, that this aspect of financial advisory can offer.

The Psychology of Investing

Investing is not only a financial endeavor but also a psychological one. Investors' emotions and cognitive biases can significantly influence their decision-making process. In this chapter, we will explore some common cognitive biases and emotional tendencies that affect investors' actions.

Loss Aversion: One of the most well-known behavioral biases is loss aversion. Investors who exhibit loss aversion feel the pain of a loss more strongly than the pleasure of an equal gain. This can lead to irrational decisions, such as holding onto losing investments for too long or selling winners too soon.

Overconfidence: Overconfidence can cause investors to overestimate their abilities, leading to excessive trading and increased risk-taking. Overconfident investors may also under-diversify their portfolios, putting their investments at greater risk.

Confirmation Bias: Confirmation bias is the tendency for investors to search for and favor information that confirms their existing beliefs while ignoring or downplaying contradictory evidence. This can lead to an overemphasis on positive news and a disregard for negative information, resulting in poor investment decisions.

Recency Bias: Recency bias occurs when investors place too much importance on recent events and extrapolate them into the future. For example, if the stock market has been performing well recently, investors may expect the trend to continue indefinitely, leading to overly optimistic expectations and increased risk-taking.

Herd Mentality: Herd mentality is the inclination to follow the actions of the majority, even if those actions are not in line with one's own best interests. This can lead to investment bubbles and subsequent crashes, as investors flock to popular investments without considering the underlying fundamentals.

The Role of Financial Advisors in Behavioral Coaching

Financial advisors play a critical role in helping clients overcome these psychological pitfalls. By understanding and addressing the cognitive biases and emotional responses that drive investor behavior, advisors can help their clients make more rational and informed decisions. Some key aspects of this role include:

The Importance of Empathy and Active Listening: Financial advisors need to be empathetic and actively listen to their clients' concerns and emotions. By understanding their clients' feelings, advisors can identify the underlying biases and emotions driving their decisions and address them effectively.

Identifying and Addressing Clients' Biases and Emotional Responses: Financial advisors should be well-versed in common behavioral biases and be able to recognize them in their clients. Once these biases are identified, advisors can help clients understand their influence and develop strategies to mitigate their effects.

Developing Trust and Rapport with Clients: Trust is a critical component of the advisor-client relationship. Clients who trust their advisors are more likely to heed their advice and stay the course during difficult market conditions.

Educating Clients on Market Realities and Investment Principles: One of the most effective ways to combat behavioral biases is through education. Financial advisors should help their clients develop a solid understanding of market realities, investment principles, and the importance of a long-term perspective.

Real-life Examples of Behavioral Coaching

In this chapter, we will explore four real-life examples of how financial advisors have used behavioral coaching to guide their clients through various challenges and help them achieve their financial goals.

Case Study 1: Navigating a Market Downturn

John, a 45-year-old investor, became increasingly worried about his investments during a market downturn. Panicked by the declining value of his portfolio, he considered selling his stocks and moving his assets to cash. His financial advisor, Susan, recognized John's loss aversion and fear-driven decision-making. She reminded him of his long-term financial goals and the historical resilience of the market. By explaining the potential consequences of selling at a low point and reinforcing the importance of staying the course, Susan helped John resist the urge to make an impulsive decision that could have significantly damaged his financial future. By staying invested, John was able to achieve higher returns as the market rebounded. Investor's who sell during market downturns tend to lock in their losses.

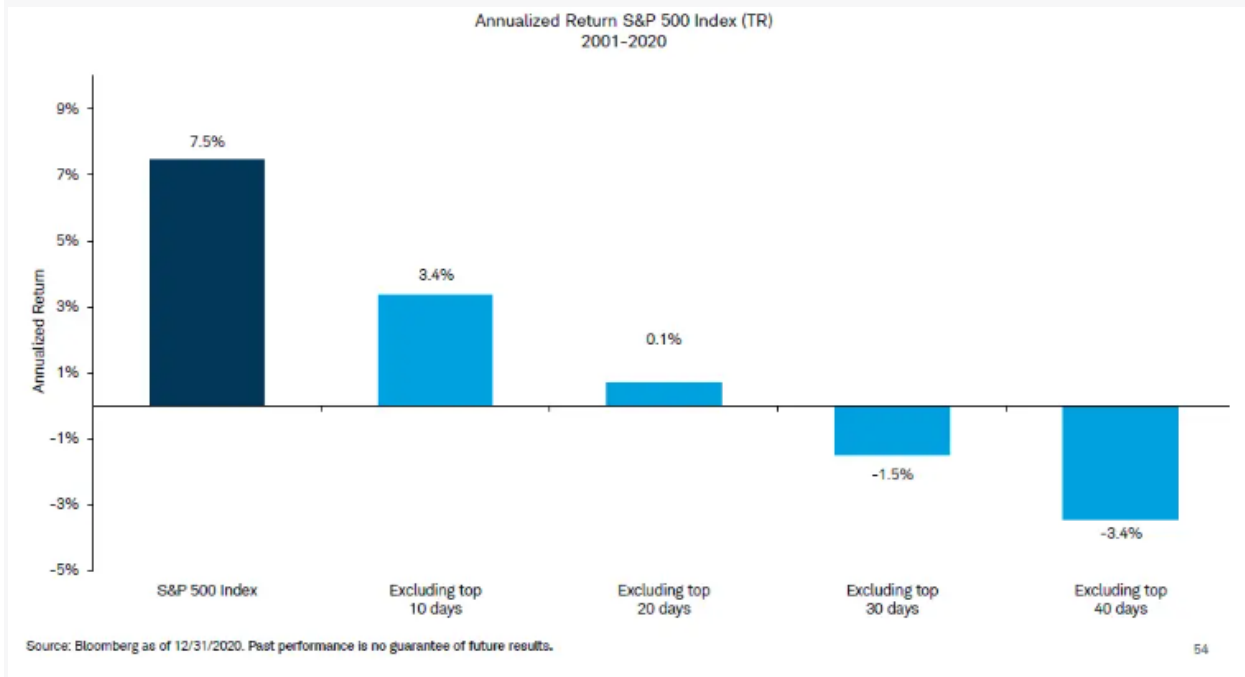
Case Study 2: Coping with the Fear of Missing Out (FOMO)

Melissa, a 32-year-old investor, started noticing her friends and colleagues talking about their gains from a high-flying tech stock. She began to feel like she was missing out on a golden opportunity and wanted to invest a significant portion of her portfolio in the same stock. Her financial advisor, Tom, recognized that Melissa was experiencing FOMO, which was driving her to make an emotionally charged decision. Tom reminded Melissa of the importance of diversification and the risks associated with concentrating too much of her portfolio in a single stock. By guiding her through a rational analysis of the stock's fundamentals and discussing the potential risks, Tom helped Melissa resist the allure of chasing returns and maintain a balanced investment approach. Most friends and family will tell you how much money they made in certain investments. However, people are much more hesitant to talk about their losses. Being aware of FOMO will help investors avoid chasing "get rich quick" investments.

Case Study 3: Overcoming the Urge to Time the Market

Robert, a 55-year-old investor, believed he could successfully time the market by moving in and out of stocks based on his predictions of market fluctuations. His financial advisor, Lisa, understood that overconfidence was driving Robert's investment strategy. She presented him with historical data demonstrating the difficulty of consistently timing the market and the potential costs of missing out on gains during market recoveries. By highlighting the benefits of a long-term, buy-and-hold strategy, Lisa helped Robert reevaluate his approach and adopt a more disciplined investment strategy.

Below is a graph that illustrates the importance of staying invested during times of volatility. The best days in the market are usually during times of volatility.



Case Study 4: Resisting the Allure of "Hot" Investments

Jane, a 40-year-old investor, became intrigued by a new, trendy investment opportunity that promised high returns. She wanted to invest a significant portion of her savings in this venture, despite its high risk and limited track record. Her financial advisor, Mike, recognized that Jane's excitement and desire for high returns were clouding her judgment. Mike discussed the potential risks of the investment and emphasized the importance of maintaining a well-diversified portfolio. Through this behavioral coaching, Jane was able to resist the temptation of the "hot" investment and maintain a more prudent investment approach.

Quantitative Benefits

The impact of behavioral coaching on portfolio returns can be significant. By helping clients avoid common pitfalls and make more informed decisions, financial advisors can add substantial value to their clients' portfolios. This chapter will explore the quantitative benefits of behavioral coaching, measured in basis points, that financial advisors can provide.

Basis Points Added Through Effective Coaching:

- Morningstar Study: A study conducted by Morningstar found that effective behavioral coaching can add up to 150 basis points (1.5%) to clients' annual returns[1]. By helping investors avoid common mistakes and maintain a long-term perspective, financial advisors can have a significant impact on their clients' overall investment success.
- Vanguard Study: Vanguard's research also supports the idea that financial advisors can add substantial value through behavioral coaching. Their study suggests that financial advisors can potentially add 300 basis points (3%) or more to clients' net returns annually, with a significant portion attributed to behavioral coaching[2].

The Long-term Benefits of Improved Investment Decision-making:

The quantitative benefits of behavioral coaching extend beyond just annual returns. By guiding clients toward more rational and informed decisions, financial advisors can help clients build and maintain more robust and well-balanced portfolios, which can lead to better long-term investment outcomes.

The value-add of best practices in wealth management

Vanguard Advisor's Alpha strategy	Module	Benefit of moving from the scenario described to Vanguard Advisor's Alpha methodology
		Typical value added for client (basis points)
Suitable asset allocation using broadly diversified funds/ETFs	1	> 0*
Cost-effective implementation (expense ratios)	2	30
Rebalancing	3	14
Behavioral coaching	4	0 to > 200
Asset location	5	0 to 60
Spending strategy (withdrawal order)	6	0 to 120
Total return versus income investing	7	> 0*
Total potential value added		Up to, or even exceed, 3% in net returns

* Value is deemed significant but too unique to each investor to quantify

Notes: We believe implementing the Vanguard Advisor's Alpha framework can up to, or even exceed, 3% in net returns for your clients and also allow you to differentiate your skills and practice. The actual amount of value added may vary significantly, depending on client circumstances and time horizon.

Source: Vanguard.

Tips for Clients to Maximize the Benefits of Behavioral Coaching:

Clients play an essential role in the success of behavioral coaching. By being receptive to feedback, open to self-reflection, and committed to a long-term perspective, clients can maximize the benefits of their financial advisor's behavioral coaching. Here are some tips for clients to make the most of their advisor's guidance:

- **Being Open to Feedback and Self-Reflection:** Clients should be willing to listen to their advisor's insights and be open to examining their own biases and emotional responses.
- **Embracing a Long-term Perspective:** Clients should focus on their long-term financial goals and resist the temptation to make short-term, emotionally driven decisions.
- **Developing a Strong Relationship with Your Financial Advisor:** A trusting and open relationship with your financial advisor is crucial for successful behavioral coaching. Clients should feel comfortable discussing their emotions and concerns with their advisor.
- **Practicing Patience and Discipline in Investing:** Clients should remind themselves of the importance of patience and discipline when making investment decisions, particularly during times of market volatility.

Conclusion:

Behavioral coaching is a valuable service provided by financial advisors, which can significantly impact clients' investment success. By understanding the psychological factors that influence investor decisions, financial advisors can help clients navigate the complex world of investing and overcome the biases and emotions that often derail their financial goals. With the potential to add significant basis points to portfolio returns, behavioral coaching is an essential component of a comprehensive financial advisory relationship.

Questions about how a financial advisor can help you maximize your portfolio performance and provide behavior coaching? Please call us today at (641)585-4000 to schedule a free consultation.



Sources:

[1] Blanchett, D., & Kaplan, P. (2013). Alpha, Beta, and Now...Gamma. Morningstar. <https://www.morningstar.com/content/dam/marketing/shared/research/foundational/677796-AlphaBetaandNowGamma.pdf>

[2] Kinniry Jr., F. M., Jaconetti, C. M., DiJoseph, M. A., Zilbering, Y., & Bennyhoff, D. G. (2019). Putting a value on your value: Quantifying Vanguard Advisor's Alpha. Vanguard Research. <https://www.vanguard.com/pdf/ISGQVAA.pdf>

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