Journal of FINANCIAL PLANNING The Official Publication of the Financial Planning Association

Communicating to Overcome Client Market Fears

by Laurie Budgar

The recession may be technically over, but investor wariness isn't. Clients showing up for their annual meetings with advisers are expressing fear about where—or whether—to invest their money. Many are taking larger cash positions than anyone would recommend under any circumstances. In fact, a white paper published in June by Prudential[1] reported that 44 percent of investors say they are not likely to put more money in the stock market ever again. What are the real fears holding investors back from the market? And what can financial planners do to help them move beyond those fears?

Stirring the Pot

A Gallup poll in May found that investor optimism—among those who weren't retired—was declining again for the first time since February 2009.[2] Investors cited high energy costs as their top concern, but also said the federal budget deficit and the unemployment rate were hurting the economy. So even as gas prices came down over the summer, investors continued to mop their worried brows.

During the week ending July 17—just as political discussions over the federal debt ceiling were reaching a fevered pitch—consumer confidence sank to its lowest point since March 2009.[3] A Gallup poll the following weekend[4] found that nearly three-fourths (73 percent) of Americans thought the economy was getting worse. Gallup's analysts attributed the decline in confidence primarily to the debt limit controversy, but noted that actual defaults in Europe and the lack of job creation in the United States were also likely contributing factors. In August, the Dow plunged more than 500 points and the S&P 500 plummeted 60 points in a single day, spiking the Chicago Board Options Exchange Volatility Index (VIX) to 32—the first time all year it went above the "high fear" threshold of 30, and analysts pegged the freefall to fears of a global economic setback.

The pundits aren't always right about what consumer fears actually are, however. Earlier in the year, an MFS Investment Management survey found that although 20 percent of advisers thought their clients' top fear was a major stock market drop, only 5 percent of investors listed it as a top concern. Instead, investors reported their top concern for the next 12 months[5] was:

1. Rising health care costs (17 percent)
2. The growing federal deficit (17 percent)
3. Reduction in Social Security benefits (13 percent)
4. High unemployment (11 percent)
5. Increase in federal, state, or local taxes; legislative gridlock; and rising inflation (three-way tie at 7 percent)

It's almost as if Americans aren't certain what to be afraid of anymore. Certainly, recency bias—the human tendency to focus on whatever is making the news that week—plays a role. Likewise, people remember recent losses more acutely—like those incurred during the 2008 financial crisis—and base future decisions on them, according to a white paper by Shlomo Benartzi, Ph.D., chief behavioral economist at the Allianz Global Investors Center for Behavioral Finance.[6] But at some point, all the fears begin to coalesce.

"There's a wall of worry that's being climbed, much more so than we ever thought was really as important to the investor as it is today," says Bill Finnegan, senior managing director of retail marketing for MFS. "It has to do with the amount of information, but also the speed of information. … [Investors are] hearing a lot about health care, the national debt, U.S. competitiveness, unemployment, the global economy, tax increases—there are so many things lined up in front of investors it makes them naturally conservative."

Fear and Loathing in Finance

Much of that response is hard-wired. When humans encounter a threat, the brain is flooded with stress hormones such as adrenalin and cortisol, and this physiological cascade—the classic "fight or flight" response—actually inhibits clear, rational thinking and promotes instinct-based behavior.

"Fight or flight is valuable when we are faced with surprise attacks from saber-tooth tigers, but it doesn't really help us preserve our 401(k) plan in the face of a financial threat," says Andrew Lo, Ph.D., chairman and chief investment strategist at Cambridge, Massachusetts-based AlphaSimplex, and director of the MIT Laboratory for Financial Engineering.

Fear isn't even the only emotion driving irrational behavior among investors, says Richard L. Peterson, M.D., a psychiatrist turned behavioral finance specialist and author of Inside the Investor's Brain. He and his colleagues at MarketPsych have developed "sentiment indicators"—software that analyzes language in social media to determine the zeitgeist—and they've found that for many people, anger and disgust have replaced fear. No matter, says Peterson, the effect is the same: "All energies become focused toward the problem—in this case, politics. People are getting agitated; they're calling a congressperson, arguing with co-workers. But people don't take financial risks [in these situations]."

Lo says today's market is different from any other bear market Americans have experienced. "People are happy to take risks as long as they know in advance: these are the risks, these are the rules, these are the worst-case scenarios. What we've seen over the past year are too many surprises."

The Communication Cure

To get clients to move past their emotions, many planners try to get them talking. Expressing the emotion helps reduce its intensity, Peterson says, which helps investors engage in more rational conversations with their planners.

And planners who communicate more frequently with their clients—especially during periods of economic turbulence—have higher levels of client satisfaction, trust, and retention, and higher gross revenue, according to numerous studies.[7] But only two-thirds of planners are getting the message. According to research conducted by the Financial Planning Association in March,[8] 34.2 percent of FPA members don't have a formal communications plan in place. More than half of those without a plan say they spend less than 10 hours a week communicating with clients. And they're likely losing more than their clients' trust as a result. Two-thirds (69.4 percent) of those who say they spend fewer than 10 hours per week communicating experienced an overall increase in their client base in the preceding 12 months, compared with 82.3 percent of those who spend 10–14 hours per week.[9]

Even those with formal communications plans remain traditionalists, communicating most often around portfolio and goal reviews. Still, a healthy 68.4 percent of advisers say they call just to check in and see how clients are feeling. A similar number (66.6 percent) touch base with economic or market updates.

Successful planners know that clients won't always initiate conversations about their fears. "We weren't getting a lot of questions [during the 2008 and 2009 financial crisis], but we knew clients would have to be living in a vacuum to not know what was going on," says Roy Diliberto, ChFC, CFP®, chairman and CEO of RTD Financial Advisors in Philadelphia, Pennsylvania. Diliberto's team increased its communication with clients at this time, emailing newsletters and setting up meetings to discuss the situation.

Means of Communication

Diliberto's communication vehicles mirror typical planner use in some ways. Almost 70 percent of advisers frequently or occasionally use newsletters—whether sent by email or postal service—to communicate, according to research FPA completed in 2011. Overwhelmingly, planners communicate via email (98.1 percent) and face-to-face meetings (97.9 percent). A smaller percentage has adopted social media options: 19.2 percent use LinkedIn, 12.6 percent use blogs, 10.4 percent use Facebook, 6.9 percent use Twitter, and 6.2 percent use other social media.

SEI, an Oaks, Pennsylvania-based adviser network, found in a similar survey that 11 percent of advisers used social media; in those cases it was largely for recruitment of new clients.[10]

Many investors wish their advisers were a bit more comfortable with technology. A Fidelity study found that 85 percent of millionaires use text messaging, smart-phone apps, and social media, and 66 percent said they'd like to use tech-enabled media with their advisers.[11] They may be out of luck for now, though. "Regulatory requirements mean you can't say much [in a social media format], so it's hard to make it entertaining or provocative," Peterson explains.

In their defense, many planners use technology more frequently with certain subsets of their clients. Nearly a third (31.3 percent) say they change both the content of their message and the method of communicating depending on the client segment —often defined by client preferences, age, or net worth. Those who use email, however, seem to be particularly loyal to it: 75 percent of advisers who typically use the same communication vehicle for all their clients frequently or always use email.[12]

Addressing the 800-lb Gorilla

Regardless of how they communicate, few planners try to vanquish client fears with historical data and trends. It wouldn't do any good, anyway, says Carol Anderson, president and CEO of Poulsbo, Washington-based coaching firm Money Quotient and co-author of a 2008 study on the subject. "[Those who do] are trying to use left-brain rational arguments to address right-brain emotions and concerns."

Besides, says Peterson, "Historical data's not going to work because everyone knows we're in uncharted territory."

So most planners now find themselves playing the role of therapist to a certain extent. "You can't ignore fears when they're legitimate," Diliberto cautions. "I want to understand what clients are feeling and honor it."

Sometimes that means more than talking. For example, if a client is terrified that Social Security will tank, Diliberto runs projections without the retirement income and sees what that future looks like. Even when fears seem less than reasonable—like the time a client called Diliberto after dreaming she had water up to her chin and wanted to move everything into cash—listening provides the kind of validation clients often need to calm down.

Ultimately, Diliberto says, he and his colleagues endeavor to prevent fears around market volatility from affecting investment decisions, regardless of the validity of the fear. "We're going to try to take the fear away from them and give it to us. We want them just to go about their lives. … We don't want to be cavalier about it, but by the same token, that's why you're hiring us to do these things. If you were able to do them yourself, you wouldn't need us. You're not unable to do it because of the knowledge; you're unable to do it because of emotion."

Emotional Healing

Of course, even the best financial planners have emotional reactions to market volatility, too, which could lead to providing inferior advice, says Doug Lennick, CEO and founder of the Lennick Aberman Group, a performance-enhancement consulting firm in Minneapolis, Minnesota. Most people, unfortunately, are not adept at recognizing when emotions are coloring their judgment—or at least not until after the moment has passed and the damage is already done.

"We teach people to make the skill of recognition a habit," Lennick says. "When the emotional center hijacks the rational center, the default is to the habit center. So what you want is a habit of paying attention to yourself," he says. To develop the habit, he recommends playing what he calls "the freeze game": anytime you get into a car, get out of an elevator, turn on the TV, or perform any number of other commonplace acts, freeze for a moment and pay attention to what you're thinking, what you're feeling, and what you're doing.

The exercise is likely to pay off. Lennick says research at more than 200 companies shows that emotional competency has more than twice as much impact on performance as cognitive and technical skill combined. And a second survey that Peterson et al. conducted with more than 2,600 investors[13] found that those who don't notice their emotional reactions tend to have greater financial losses. Similarly, those who are the most emotionally stable have the greatest profitability, the report concludes.

A perfect example of this was in March 2009, when Diliberto's software program alerted him that clients' portfolios had fallen outside preset tolerance ranges. "If you had told me [then that] the best place to have my money was REITs, I would've told you that you were nuts. … But the tolerances said we had to sell bonds and buy real estate. Every single one of our clients has more money now than they did when everything was in the tank. … I would like to tell you I'm smart, but it has nothing to do with smarts." It has everything to do, Lennick would say, with emotional competence.

That's why it's important to educate clients about the role emotion plays in their decision-making framework. "They're not going to stick to the plan if they don't understand that the reactions they're going to have [to market volatility] are not going to be productive," Lo says. But you can't stop there. "They're likely to wonder, 'OK, now that you've told me I might freak out and act in ways that are unproductive to my financial wealth, what should I do next?'"

At that point, it's time to have a conversation with them. First, talk about their goals and dreams, the role of money in their lives, their personal challenges—all information that, hopefully, you've already discussed during your initial meeting and during portfolio reviews. And then talk about whether their portfolio is still supporting those values. "What it really gets down to is how does [turbulence] affect you personally and your ability to reach your goals?" Diliberto says. When clients know you understand their values, they're more likely to trust you to make the right decisions in turbulent times, he adds.

That's not just feel-good advice; plenty of research backs it up. According to *Bridging the Trust Divide*, a white paper co-authored by State Street Global Advisors and Knowledge@Wharton,[14] advisers who integrate discussions of personal and family concerns with financial health engender greater client loyalty as well as trust in their competence. And Anderson's 2008 study with Deanna L. Sharpe, Ph.D, *Communication Issues in Life Planning: Defining Key Factors in Developing Successful Planner-Client Relationships*[15] showed a very strong statistical correlation ($p < .001$) between planners who helped clients clarify their personal priorities and clients' level of trust and commitment. It also led to higher levels of disclosure of personal and financial information.

And that, in turn, will help your bottom line. Peterson's success traits survey[16] found that advisers who emphasize relationships over investment returns had higher gross revenues.

Peterson also teaches planners to ask clients early on what their long-term goals are for their money. Whether it's making an endowment to their alma mater or buying a lake house, the more vivid and real the goal is, the better. Help them picture the stadium on campus bearing their name, Peterson suggests. "Then, when you have market turbulence you can say, 'If we sell now, there's no way we're gonna make that goal. If we ride this out, we might. If we sell at this low price, we definitely won't.' We call it the regret factor."

Researchers at Allianz have been working on technology that goes visualization one better. Hal Ersner-Hershfield and his colleagues found that when they used age-regression software to create a virtual image of what an investor would look like decades later, investors more than doubled the amount of money they agreed to allocate to retirement savings. Results were even more pronounced when the images of those future selves showed emotional reactions (for example, broad smiles when savings were great and deep frowns when savings were slim). The researchers are working to make the technology available free to financial advisers for use with their clients. As of press time, the Behavioral Time Machine was expected to be released for commercial use this fall.

Contingency Plans

It's also helpful to create contingency plans. Before the market drops 20 percent, and while your clients are still unemotional about it, discuss what they'd like to do under that and other scenarios—and put it in writing.

"It makes all the difference in the world when you get a phone call [and your adviser says], 'We talked about crises a couple years ago. We're executing the plan now, checking the volatility of all your investments, taking down your exposure to volatile ones the way we agreed.' The call may not take more than three minutes, but it provides an enormous amount of relief to investors who don't know what's going on," Lo says. And, according to the Allianz white paper, reminding clients of the written plan helps them resist "the siren call" of the emotional/intuitive mind and recommit to achieving their goals.

Developing contingency plans helps prepare clients for the "certainty of uncertainty," which is more important than managing the risk of volatility, Lennick says. "If I can prepare you for uncertainty, that's going to take a lot of risk out of your life. It won't take risk out of investments. It's saying, 'I don't know how long you will be healthy, I don't know if the economy will go up or down, I don't know what will happen in the Middle East or Asia. I have some educated guesses.'" But if you prepare for multiple scenarios, he says, clients will always have a smart place to get money, no matter what happens in their lives or in the world.

Still, many investors feel uneasy about relying on the same asset classes they did before the crisis. According to the MFS survey, only 35 percent of investors now think equities are good investments. And Prudential's survey—the one that showed nearly half of investors may not ever put money in the stock market again—also found that 61 percent of investors believe that traditional principles of investment diversification and asset allocation have changed.[17]

Lo thinks those investors are right on the money. "The old rules of thumb—like 60/40—were maybe reasonably effective in benign economic environments with an 8 percent risk premium. When you have assets like the S&P 500 that has volatility of 50 percent one day, 20 percent the next, 30 percent the next, this kind of volatility roller-coaster ride is not what investors signed up for, and not what 60/40 was designed to achieve. We need to rethink the investment framework we expect financial planners to use."

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