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Give your clients a confidence boost in today's environment

Feedback

Michael DiJoseph

Senior Advice Strategist

The coronavirus pandemic has exacted a staggering toll in terms of economic impact and the loss of life. It has also produced many heroes, including frontline health care workers and retail employees who enable people to stay well provisioned in isolation.

Financial advisors can serve a critical role as well by helping clients maintain their emotional well-being and increase their chances of emerging from the crisis with their financial dreams intact.

Vanguard Senior Advice Strategist Mike DiJoseph recently answered a number of advisors' questions on how to help clients manage their emotions. He explained that taking such a behavioral coaching approach can help clients avoid making in-the-moment, reactionary decisions they may regret in the long run.

DiJoseph suggested approaching engagements with clients by using a “three A’s” framework (see graphic below):

- Assess the situation that demands a behavioral coaching solution.
- Address it by developing an appropriate course of action.
- Audit the results and discuss them with clients, demonstrating yo value in the process.

Feedback

Behavioral coaching: three A’s of action for advisors

Source: Vanguard.

Following is a summary of DiJoseph's question and answer session w advisors.

How do you keep clients focused on long-term risk during crises such as the coronavirus pandemic?

First, it's important to provide perspective on what a crisis happening in the moment is. So our team at Vanguard examined the questions: What do bear markets look and feel like in the moment and how does that compare with perceptions after the fact, with the benefit of hindsight?

For example, we looked at the bear market from 2008 through 2009. We examined news headlines from that period and noted the overall sentiment of gloom they conveyed.

We tracked the Standard & Poor's 500 index from its market bottom in March 2009 to its recovery breakeven point less than two years later. By the time the headlines expressed positive sentiment, the market had already completely recovered.

We're not saying that scenario will play out again in the same way. And today's crisis has the added dimension that it's threatening people's physical health. At the same time, it doesn't mean this situation is never going to get better. We, as people offering our financial expertise, just need to provide that perspective. That's the first part.

The second part of keeping your clients thinking long term is to actually talk about what long term means to them. For most investors, it means meeting their goals. So I would suggest talking about what's going on in terms of a client's percentage progress toward those goals. Is the client still on track? Most advisors have already planned for periodic downturns that affect client portfolios. So it's good to remind clients of that.

How do you help clients who still want to sell out of the market base on extreme panic or fear?

Oftentimes you just have to meet clients where they are. If you have a client who's responding with emotions, I think you need to meet the client with emotions. If you have somebody who's responding analytically, your initial engagement similarly would be analytic: Show the potential impact of what happens if the client bails out to cash, what returns the client might expect, and how the client's ability to meet their goals might change.

I think for most people, investors and professionals alike, the most effective appeal is a combination of the two. This is the "assess" part of the three A's framework: What happened to bear markets in the past and what happened in health crises in the past? How did those play out?

A huge part of this step is applying emotional intelligence and serving as the calming voice of reason—after letting the client voice their concerns in their own way. You may have heard of this referred to as "EQ," or having the emotional quotient to interact sensitively with others. As an advisor, you need to have confidence that the work you've done upfront to put a plan in place will see a client through difficult times.

Depending on how clients react to that, sometimes it really does just come down to finding a compromise. Maybe you have a client who wants to completely bail out of the market no matter how much analysis you provide them with, no matter how emotionally soothing your advice may be: They're just not really having it.

And in those cases, you might want to look at a very small bit of de-ris or even framing a decision not to rebalance as something that reduces

How should you talk with clients who are retirees or who want to retire soon?

If a client just retired within the last year or two, or if the client is thinking about retiring next year, now can be a particularly scary time.

The good news is there are a ton of things you can do as an advisor to add value. So when we're talking about assessing that situation, you want to look into the client's plan and see what their spending requirement is. What are those end goals?

Then, you need to *address* the situation—the second component of our framework—and there are a number of tools you can use.

So, for example, many clients may have some tax losses that can be harvested. You should think about potentially cleaning up the portfolio itself with tools such as rebalancing, but there are also things such as asset location. That is, how are the assets distributed across different types of accounts, i.e., tax-deferred accounts, tax-free accounts, and taxable accounts?

You can also address retirement spending. Our team at Vanguard has done research for years on what happens during market downturns when it comes to spending rates and spending strategies. What we've found is that decreasing spending by just 2.5% in lean years and increasing it a little bit in prosperous years—a concept we call dynamic spending—can have dramatic positive effects on the long-term outcome and viability of a portfolio.[1]

What is the distinction between cognitive error and emotional bias And how can you mitigate the counterproductive effects of your clients' biases?

We do need to draw a sharp distinction between behavioral finance and behavioral coaching. With behavioral finance, we're talking about the heuristics and biases—why people make the decisions they do, why those decisions aren't always rational, and why they may lead to bad outcomes.

You could consider it a really scientific way to look at it. I liken it to IQ. I think behavioral coaching is really applying the EQ, the emotional intelligence, to connect with a client and overcome their natural biases. There is an intellectual aspect to it as well, but you're really keying in on the client's emotional state to guide them toward better financial decisions.

It's worth noting we've published work on the importance of positivity when you're engaged in behavioral coaching.[2]

It ties back to the idea mentioned earlier, of meeting emotion with emotion. It really comes down to positivity. And by that I don't mean, "Hey, everything's fine, the market's not down, and we're not in the middle of a health crisis." Clients obviously know that's not true.

Instead, I'm talking about reframing the situation: Being upfront about clients' reactions and telling them, "Hey, they're natural."

"You feel like you want to bail from the stock market today. It's natural to think that because it's gone down for the last two or three weeks, and it's likely to happen again. That's okay."

The positive aspect of this is simply acknowledging that it's okay for them to have those worries. Fortunately, they've hired you to prepare them for something like this happening. That's how you can make your clients feel a little more empowered—reminding them that their portfolios are prep to weather the storm we're in right now.

Is there a way to use this unique environment as an opportunity when it comes to prospecting and potentially helping a greater number of clients?

You're in the trenches with your clients in these trying times, building trust in the process. I think that will pay dividends as the clients you help today go forth, after the dust settles, and articulate their experience working with you. They will remember the way that you made them feel, and they'll talk about it with potential prospective clients.

Something you might consider in the "opportunity basket" is everything we've been seeing and hearing with the move to digital. In less than a month, we've undergone a massive societal change. We've transitioned from an office-based, person-to-person service paradigm to a setting where everything—in our space, at least—is digital.

This is an interesting issue to think about for the audit portion of our framework. It's a chance to really consider how you connect with others. And I think that's going to be a big opportunity. We can see how this may be an inflection point for a world where geographic boundaries become less important in the advice industry. So I encourage you to start thinking through that—what lessons have you learned from the widespread adoption of digital meetings by necessity and how might you apply them to your advantage in the future?

A client's portfolio is positioned a bit aggressively rather than being diversified. The client wants to kn what you're doing to stop the decline?

I would reframe the client's question to, "Is their asset allocation correct in the first place?"

Asking someone how they feel about losing 30% on their investment in the middle of a crisis is probably a better depiction of true sentiment than asking a client how they feel at the height of a decade-long bull market.

There's a balance to strike, because you don't necessarily want to be making wholesale changes to the financial plan during the crisis itself. Maybe you should just not rebalance and let the asset allocation change to more conservative from there. I think that might be a good compromise.

It's a big opportunity to give your client a win—talking about diversification now when a client can see, firsthand, precisely why it matters. Contrast that to the questions you might have been hearing just a few months ago: Why the heck do I have these bonds in my portfolio when the stock market's up 30%?

On a related note, some clients say they've been severely tested and they think bonds are the way to go. Thoughts on this sentiment?

You might add some perspective on low rates going forward.

It comes down to helping the client think through that sentiment: If the client were to take that course of action, what does that look like going forward? And you should do that in a way that ties it back to the emoti aspect of helping the client remember why they're investing in the firs place—to achieve a specific goal.

So let's say you have a 50-year-old client who wants to retire in ten yea But that seems out of reach given that the client has lost 10%, 20%, 30 their portfolio value.

You have to ask yourself, well, "What are the alternatives?" The alternative of reallocating assets to cash investments is probably going to get a zero return. With a reallocation to bonds, I think we all believe that bonds will continue to be a diversifying asset and a ballast to equity risk but I'm not sure bonds are really going to be a high-income-producing asset going forward.

So put that in terms of what that means. How much does the client need for retirement and what are the client's chances of reaching that if they make the decision to rebalance? Again—with empathy—explain that abandoning equities entirely means the client is almost guaranteed to not be able to meet that goal. So just a little bit of perspective can go a long way.

1 Colleen M. Jaconetti, Michael A. DiJoseph, Zoe B. Odenwalder, and Francis M. Kinniry Jr., 2016. *From assets to income: A goals-based approach to retirement spending*. Valley Forge, Pa.: The Vanguard Group.

2 Donald G. Bennyhoff, 2018. *The Vanguard Advisor's Alpha® guide to proactive behavioral coaching*. Valley Forge, Pa.: The Vanguard Group.

Notes:

- Please remember that all investments involve some risk. Be aware that fluctuations in the financial markets and other factors may cause declines in the value of your account.

- Diversification does not ensure a profit or protect against a loss.

- Investments in bonds are subject to interest rate, credit, and inflat risk.

- There is no guarantee that any particular asset allocation or mix c funds will meet your investment objectives or provide you with a level of income.