

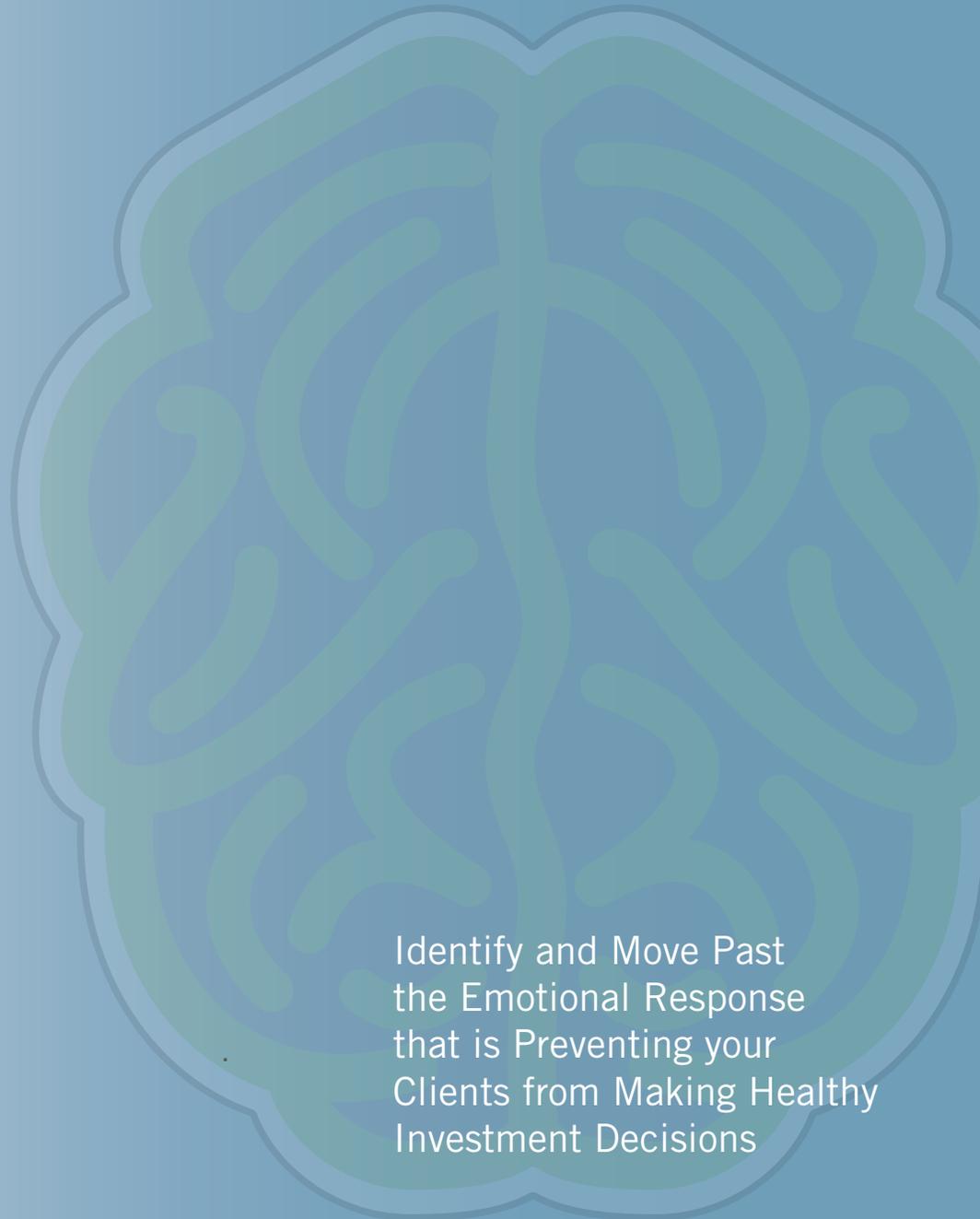


PHD

Promote Healthy Decisions

Eliminate four roadblocks to healthy investing with

Emotional Response Workbook



Identify and Move Past
the Emotional Response
that is Preventing your
Clients from Making Healthy
Investment Decisions



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Emotional Response Workbook

Anchoring	▶	Stuck in the past.
The Endowment Effect	▶	Sentiment and nostalgia overshadows rational thinking.
Short-Termism	▶	Can't see past today.
The Attention Response	▶	Overexposure and overreaction to market events.



Identify: Place a checkmark beside each statement that accurately describes your client's state.



Resolve: If you check three or more boxes in one section, follow the instructions and examples to help the client get past the emotional response (ER).

Two Approaches to Addressing Emotional Responses

When talking with a client, decide whether an intervention is appropriate or worthwhile. If so, you can choose one of two approaches:

1 Educate (overt)

Educational interventions are direct and to the point. Clients who are open and curious respond best to education about ERs. These clients are more likely to listen, be respectful, and appreciate your feedback.

Sample Advisor-Client Education

Advisor: “Sometimes people make mistakes in how they think about stocks. It tends to be when we’re responding emotionally. In fact, there’s a whole field of study, with university departments and Nobel Prize-winners, devoted to figuring out how we make misjudgments with stocks. The field is called behavioral finance and researchers say...”

Advisor: “I see where you’re coming from, and it could definitely be true. You know, there’s another possibility. It reminds me of something I once read. Researchers have found that there is a common misperception called _____, where investors _____ and it leads to long-term underperformance in the markets. If you’re interested in more detail about it, I can give you some reading material.”

2 Re-frame (covert)

Re-framing involves verbally describing another perspective. If it is done correctly, the client will develop a new understanding of their situation, and as a result, they will often feel relieved. This type of intervention is appropriate for most clients, especially when they are emotional or are poor listeners. Extensive examples of re-framing are listed beneath each ER.

ANCHORING



IDENTIFY

Stuck in the Past

Anchoring occurs when investors use a prior price as a reference point, and as a result their future expectations are unconsciously influenced by that number.

Symptoms

Does your client...

- seem to ignore new information about investments?
- frequently mention the purchase price of investments?
- appear overly influenced by unsupported forecasts (e.g., “Dow 36,000!”)?
- mention media commentary or other industry comments as reference points (e.g., “I heard an economist on the radio say oil is going to \$300.”)?
- talk about recent or all-time highs or lows when discussing merits of a position?
- feel that he/she needs to ‘break even’ with individual holdings to feel okay?

_____ Total number of check marks



RESOLVE

Move into the Present and Face the Future

Identify the client’s anchor and then either eliminate it, or establish a new one that is more congruent with their long-term interest.

Examples

1 Client: “The stock is only \$30 per share today; just four weeks ago it was \$40. I know we bought it at \$19, but I’d really like to wait until it gets back to \$40.”

Advisor: “Let’s look at the reasons why \$30 per share is a reasonable price...”

- ▶ **Establish a different kind of anchor:** “Within its sector, this stock has one of the highest P/E ratios of _____. So, even though the stock price is down, this is actually a much more expensive stock than it was.”
- ▶ **Redirect client from a positive to a negative anchor:** “It may never get back to that \$40 high given the way the subprime crisis is unfolding. In fact, I hate to say it, but this actually is a \$20 stock right now.”

2 Client: “It’s still down 8%. If it gets back to where we bought it, I say sell.”

Advisor:

- ▶ **Remind the client of the bigger picture:** It’s always tempting to want to max out. But that can be a trap that really paralyzes an investor and keeps them stuck in a position they shouldn’t be in anymore. It’s important to look at a portfolio as a whole and not as individual ‘wins’ and ‘losses’.

THE ENDOWMENT EFFECT



IDENTIFY

Sentiment and Nostalgia Overshadows Rational Thinking

The Endowment Effect is a tendency to overvalue what we own versus what we do not own because of both an irrational emotional attachment and a natural inclination toward the status quo.

Symptoms

Does your client...

- seem reluctant to change positions that he/she has inherited?
- demonstrate an emotional attachment to investments?
- frequently express their opinions for certain companies, funds, or products in terms of affection (e.g., expressions such as ‘liking a lot’, or ‘loving’)?
- confuse good companies with good stocks?
- speak about owned investments in affectionate, possessive terms while speaking of un-owned investments more analytically?

_____ **Total number of check marks**



RESOLVE

Dissolve Emotional Attachment

Move clients away from this state of mind by repositioning their perspective, updating the story, addressing the underlying emotions or explaining the *Law of Conservation of Matter*.

Example

Client: “I inherited this position from my father. I’ve had it for years and it’s been good. I don’t want to change it now.”

Advisor:

- ▶ **Reposition:** “Let’s just say someone hit a ‘restart button’ on your portfolio and all of your current holdings have been reset to cash. What positions would you use to build this new portfolio?”
- ▶ **Change the story:** “You have held it for a long time. Let’s take a look at what developments have occurred since that time that might mean a change is in order.”
- ▶ **Address underlying emotions:** “Sometimes letting go of an investment you’ve had for a while can feel like a loss. Besides the prospect of money, what are some of the things you feel like you may be losing if you sell this position?”
- ▶ **Move from loss to conversion:** “There’s a law in physics called the *Law of Conservation of Matter*; it says that matter is neither created nor destroyed—it is just converted into something else. Money works on the same principle. What are some of the things we can convert this holding into that will serve you well going forward?”

SHORT-TERMISM



IDENTIFY

Can't See Past Today

Symptoms

Does your client...

- check the status of their portfolio on a daily basis?
- express reservations about the long-term plan based on short-term events (e.g., an interest rate move, a political election)?
- have difficulty articulating long term goals and visions for their future?
- have significant credit card debt or home equity borrowing?
- talk about potential global crises as real threats to their wealth?

_____ **Total number of check marks**



RESOLVE

Extend the Time Horizon

Pull clients out of short-term views and instill a healthy, long-term perspective of their investments.

Example

Client:

"Now is a bad time to be in the market."

Advisor:

- ▶ **Reframe the crisis as an opportunity—Have stats on average performance, buying on dips:** "Volatility (the ups and downs) may feel like risk—but only in the short term. For people with long term plans, volatility is actually the investor's best friend. The only way to outperform the market is to buy low."
- ▶ **Reality Testing:** "It might be, if you needed to withdraw all your money in the next week or month. But if you have a longer term investing horizon, history tells us there is no such thing as a bad time to be in the market. (Have stats, rolling 10 year periods, etc.)."
- ▶ **Make a useful comparison the client can relate to that illustrates the point:** "The value of your portfolio goes up and down every day—kind of like the value of your house. And yet, we tend not to check the value of our houses everyday... why is that?"
- ▶ **Shifting to future focus:** "Let's talk for a moment about your long term goals, the ones you and I created together. Let's take a look at how you would like your life to look..."

THE ATTENTION RESPONSE



IDENTIFY

Overexposure and Overreaction to Market Events

The Attention Response is the tendency to overestimate the frequency or severity of an event based on greater exposure to it. It is most prevalent with people who

- 1 lack a well-grounded sense of why they hold their investments, and
- 2 follow the financial/geo-political news closely.

Symptoms

Does your client...

- watch financial news shows or read investment news articles every day?
- refer to recent news items/opinions when discussing their portfolio plans?
- use tell-tale terms like 'I keep hearing' or 'I keep seeing' when referring to what influences their opinions?
- mention the prospect of potential geo-political disasters frequently?
- want to re-position their investments due to topics recently in the news (e.g., gold rally, oil highs, China emergence, etc.)?
- talk about popular stocks or funds frequently?

_____ **Total number of check marks**



RESOLVE

Redirect the Focus

Reset the client's view to a more rational view of risk and performance. Try to immunize them to the barrage of media information that creates emotional and impulsive responses.

Example

Client: "I've been following the news and all the experts are talking about _____ happening. We may want to move more money to cash until the threat passes."

Advisor:

- ▶ **Reality Testing:** "It is a frightening prospect. But let's take a look at all the other frightening prospects that scared people out of their positions the last 10 years." (Pull out list: SARS, Bird Flu, Mad Cow, etc.)
- ▶ **Reframe to long-term view:** "We know that periodically events happen that produce market set-backs. Let's take a look at the long-term market performance despite all these negative events."
- ▶ **Worst case scenario—the catastrophe is always worse in the imagination:** "This disaster is possible. But let's look at what the end result might be. How would our lives would be different afterwards? What would be the long-term effects on the market?"
- ▶ **Reframe on personal goals, away from market activity:** "News programs, while legitimate, are motivated by ratings. They're designed to trigger an emotional response. But we know that a rational focus on our goals for the future is the only way to be successful. Let's revisit some of the reasons why we're putting our money away."



The Emotional
Response Workbook
is founded on research
by MarketPsych LLC



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