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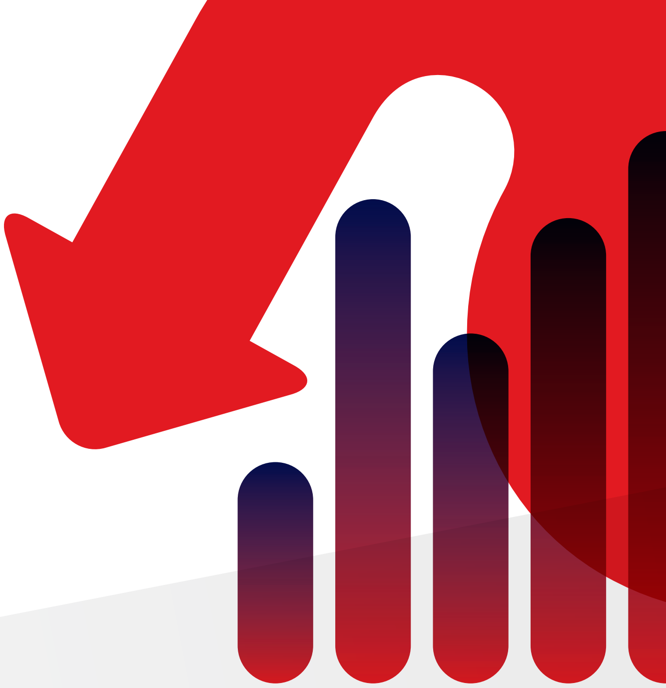


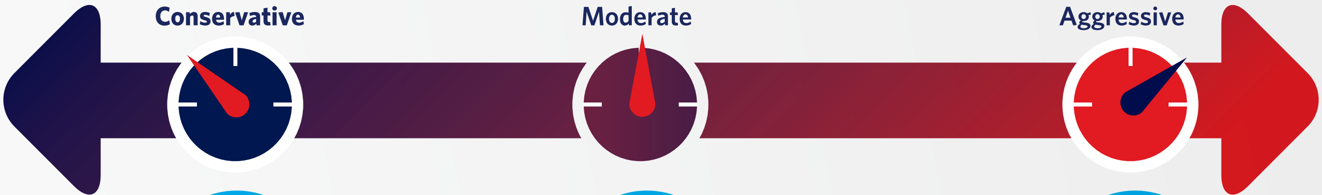
How to advise when the toast hits the floor jam side down...

Principles of financial therapy to avoid the market turbulence trap

Step 1 Know the difference between cognitive and emotional bias

Clients who are emotional about their investments need to be advised differently than those who are making cognitive errors. This infographic focuses on advising clients in market turbulence (the far left side of risk tolerance spectrum)

Risk tolerance spectrum



	Emotional	Cognitive	Emotional
Type of bias	**Endowment effect** I value investments that I own more. **Loss aversion** I feel the pain of losses greatly. **Mental accounting** I may be more sensitive to losses for the education or retirement 'pot'.	**Confirmation bias** I look for information that confirms my beliefs. **Framing** The way a prospect is worded can affect my preferences. **Recency effect** I am more conservative after a market crash. **Availability heuristic** I buy more insurance after a disaster.	**Overconfidence bias** I am always right and I have a great system of selecting investments. **Affinity bias** Take advice more easily from people they share an affinity with. **Self control bias** I tend to consume today at the expense of tomorrow.
Behaviours	1 Clients place great emphasis on financial security and preserving wealth. 2 Worriers obsessed with short-term returns. 3 Slow to make investment decisions but seek quick action in market turmoil.	1 Comfortable following the lead of friends and family (investment choices of others). 2 Often over-estimate risk tolerance being the first to complain when markets wobble. 3 Often have lazy cash balances as they procrastinate before making a decision.	1 Active investors that are strong-willed and independent thinkers. 2 Inclined to 'go with their gut' and do their own investment research. 3 Obsessed with outperforming the market and prone to holding concentrated portfolios.
Advice approach	**Financial therapy** The primary emotion here is fear and loss aversion. See a recommended advice approach on the next page.	**Quantitative (facts and figures)** The adviser needs to constantly provide factual evidence of biases. For example, when the client says, "I knew it all along", did they? Why not?	**Financial therapy** The primary emotion here is greed and overconfidence.

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Step 2 Before you get to crisis try 'stress inoculation'

A. Develop and agree to a rule-based reaction framework. Clients should commit in writing to how they will react when (**not if**) inevitable market volatility happens. For example, "I commit to wait three days or three weeks before making a switch decision".

B. Conduct scenario planning to prepare for market turbulence and what this turbulence means for each of their goal-based investments, for example the effect on long-term investments or short-term retirement income. Feeling prepared will mute reaction.

C. Teach anxious clients to widen their 'scanning' in market turmoil to include opportunities. So when discussing the negatives, we agree to talk about opportunities (what investments are likely to increase during the crisis). This dampens the crisis effect.

Step 3 Follow the principles of financial therapy (de-biasing client behaviour)

When emotion levels are running high, appealing to logic with facts and figures is unlikely to work. Recall a time you had a heated debate with friend or loved one and they told you to "calm down" or "be rational", this usually results in 'doubling down' and emotions escalating even further.

1. **Empathise:** People in an emotional state seek TO BE SEEN and HEARD. Validate their emotion and the importance of their feelings around financial security (your feelings are normal and understandable).
2. **Normalise:** Position market turmoil as 'normal'. For example, the COVID market crash on March 2020 took only three months for a full recovery.
3. **Reappraisal:** Recognise the negative thought pattern and look for different ways to view market turbulence. Market turbulence also provides investment opportunity and an opportunity to react differently.
4. **Back to the 'WHY':** Remind the client what the purpose of the investment was and refer back to the rule-based reaction framework. People seek consistency between their intentions and actions
5. **Provide the evidence:** Once the emotional state has been dealt with, use an 'evidence-based' approach. For example, during COVID clients who switched on average destroyed 6.5% of their portfolio value.