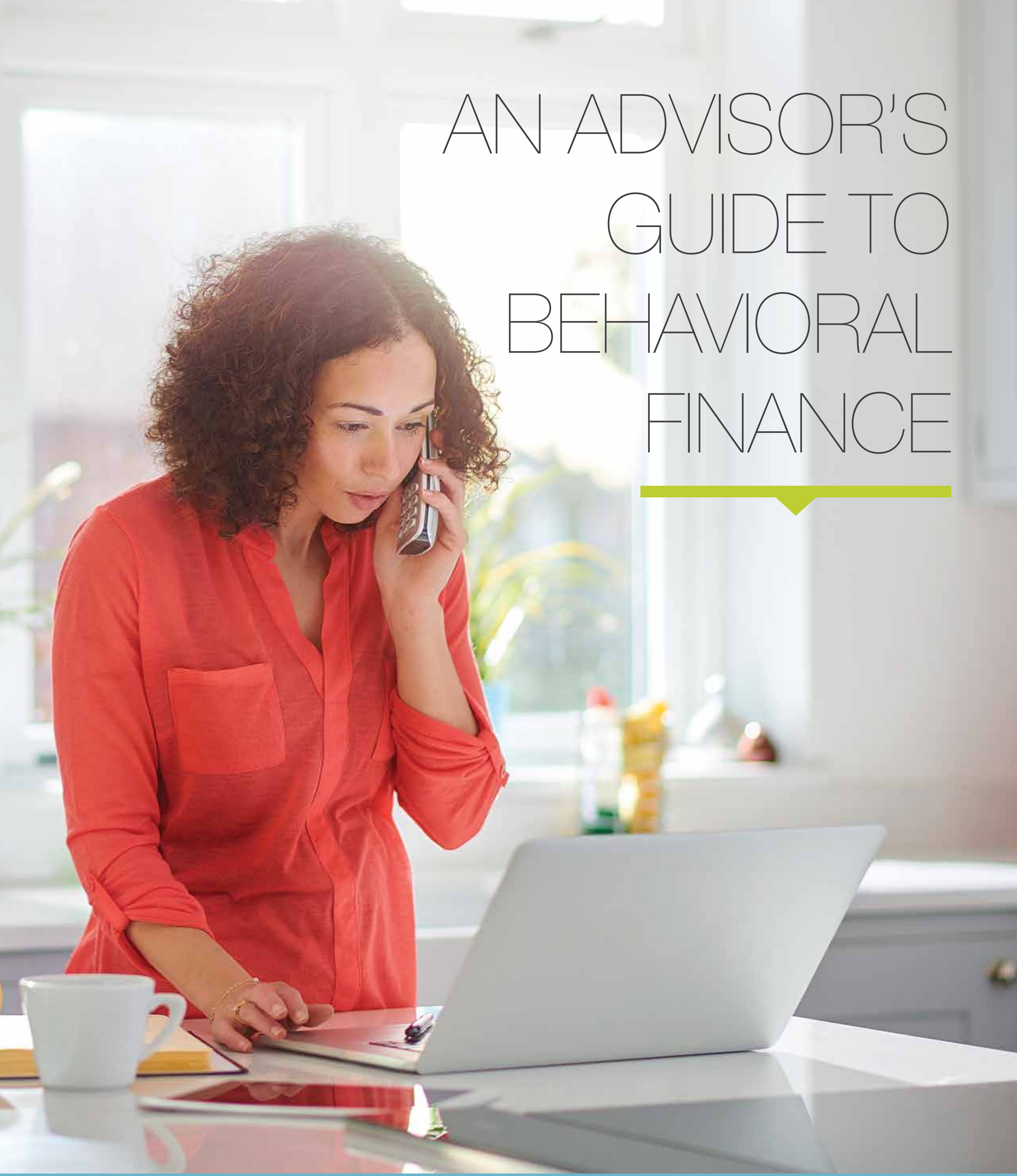
AN ADVISOR'S GUIDE TO BEHAVIORAL FINANCE



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Stress is pervasive in American society. Discussions about stress are more prevalent in the mainstream consciousness than ever, perhaps suggesting that stress is somehow a new phenomenon. However, stress has been and will remain a part of life for present and future generations. There's no practical way to escape at least some degree of stress, especially with all that many Americans have weighing on their minds:

WHAT ARE THE SOURCES OF STRESS IN OUR LIVES?

78% COVID-19[1]

77% The nation's future[1]

66% Health care[1]

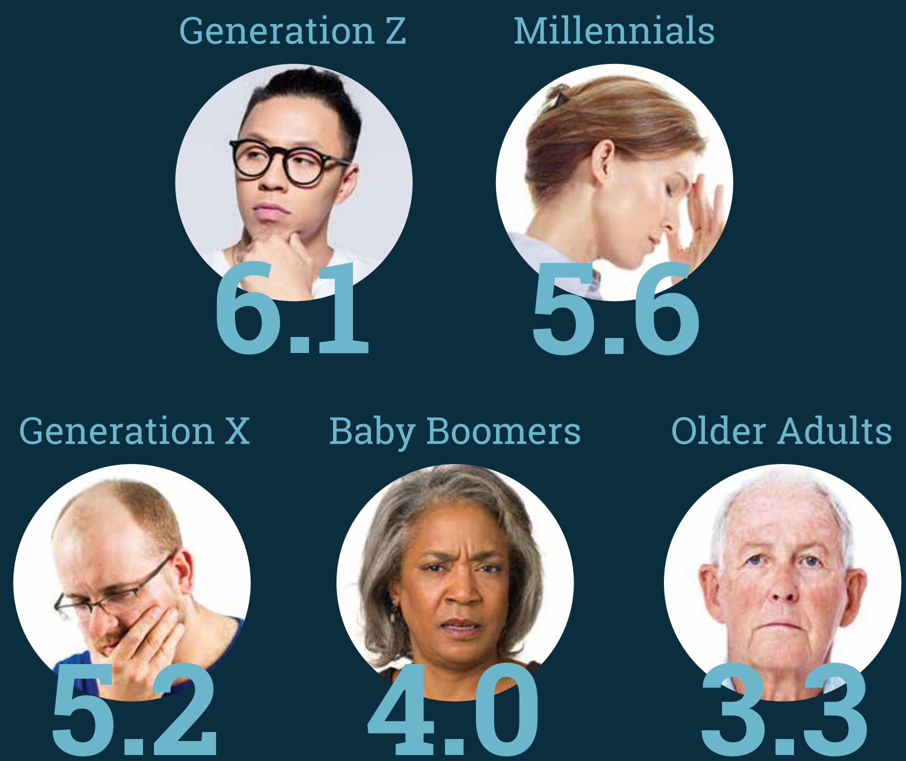
55% Climate change[1]

84% Finances[2]

Whether attributed to these identified contributors or others, each generation acknowledges dealing with some sort of day-to-day stress:

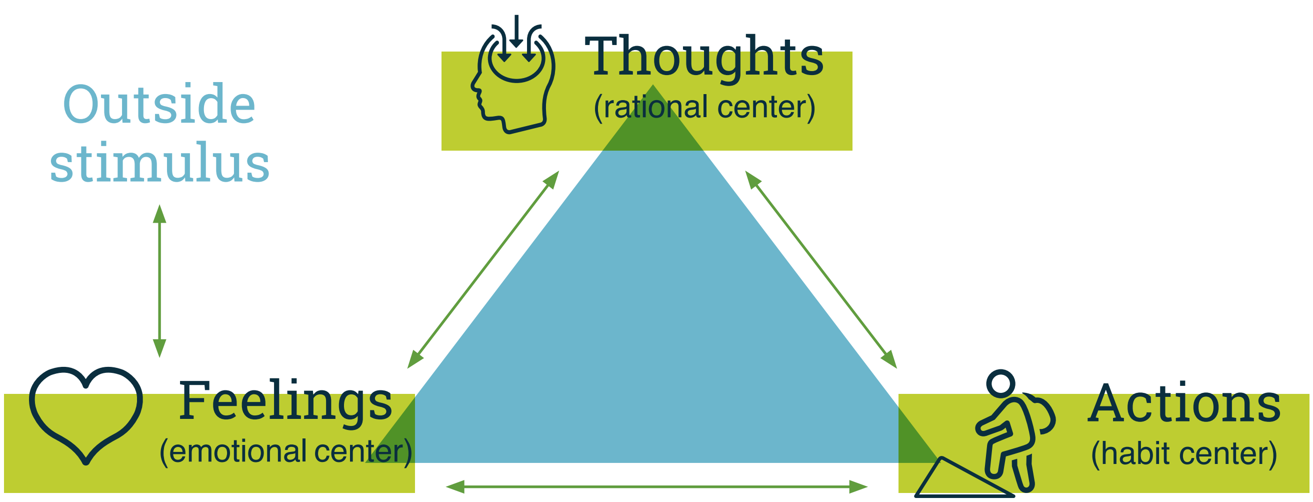
HOW STRESSED ARE WE?

On a scale of 1 to 10, average reported stress levels are significant, and they are higher for younger generations:[1]



Research proves that any amount of stress impacts decision-making by changing the way people consider risks and rewards.[3] That means anyone may be prone to making less rational decisions under stressful circumstances. This insight is particularly valuable to advisors since discussions with clients revolve around a topic that is often stressful—money.

The stress response often triggers decisions that skew to the irrational because the human brain responds to stress by reacting emotionally rather than analyzing, therefore shutting off our ability to make rational, logical decisions.[4] The natural restriction of cognitive capability creates a gap between thoughts, feelings, and actions:



Source: think2perform

Walking clients through what should be an ostensibly logical succession of investment choices and decisions suddenly becomes challenging as habitual, emotional biases take over, and the reaction can include the following:

SOME COMMON BIASES[5]

- » OVERCONFIDENCE: Holding an elevated, usually false perception of decision-making mastery that fosters an illusion of control
- » SELF-ATTRIBUTION: Claiming good investment outcomes are a result of skill, and bad outcomes are a product of sheer luck
- » HINDSIGHT: Claiming special insight into predicting outcomes after the fact
- » CONFIRMATION: Paying closer attention to details that confirm beliefs and ignoring contradictory information
- » NARRATIVE FALLACY: Choosing to create and believe a story rather than deal with the facts at hand
- » REPRESENTATIVE HEURISTIC: Believing that two similar but separate events are more closely aligned than they are in actuality
- » FRAMING: Making decisions based on how information is presented instead of the facts
- » ANCHORING: Comparing all information to that which was heard first and believing initial information to be the truth
- » LOSS AVERSION: Focusing on avoiding losses rather than making gains
- » HERD MENTALITY: Making decisions based on what the majority of other investors are doing

Reflexive decision-making fueled by these types of behaviors may lead to less than desirable outcomes or at least some regret around the path chosen.

Astute advisors can recognize these biases and help clients overcome the consequences of these behaviors, thus changing reflexive investment decisions into those that are reflective and logic-based.[5] However, to do so may take advisors getting over some biases and assumptions that are ingrained in traditional finance:

- Markets are efficient[6]
- Market prices of assets reflect all available and relevant information[6]
- All investors are rational and can separate emotions from facts when making investment decisions[6]
- All investors are well informed and current on market information[6]

These are extremely logic-based assumptions and may not serve advisors when guiding clients whose decisions are influenced by their reactions to stress, emotions, and certain situations. Being mindful not to adhere too strictly to pure logic provides advisors with latitude to integrate behavioral finance into their practices to serve clients better and more efficiently.

Why Behavioral Finance?

Focusing on how people actually behave and regarding the emotional stress reactions and resulting biases as normal rather than insisting on "rational" behavior forms the basis for behavioral finance.[5] It's a decades-old concept, but bouts of market volatility and increasing client need for behavioral guidance are bringing behavioral finance to the fore.

Since the Great Recession and the pandemic crash of 2020 may have lasting impacts on investors' confidence, market expectations, and levels of risk tolerance, guidance based upon behavioral finance may help clients improve their financial decision-making—and manage the emotions that can be associated with investment decision-making.

Services reported as most commonly provided by financial advisors include investment management strategies **(50%)**, maximizing retirement income and retirement financial planning **(47%)**. Behavioral coaching to help improve financial decision-making **(12%)** and to help manage emotions around investing **(11%)** present significant opportunities to provide greater client value.[7]

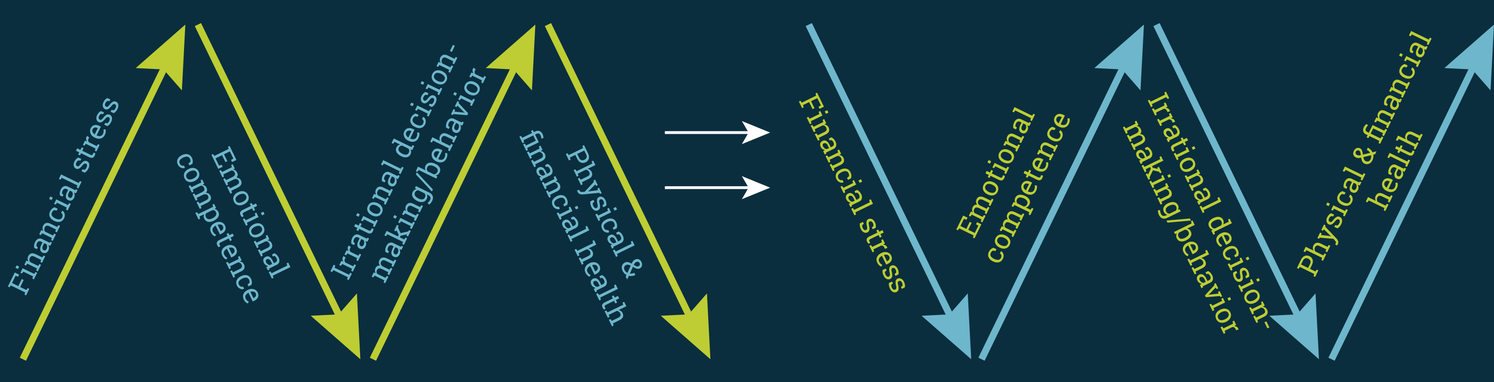
Investment Strategies	Financial Planning	Behavioral Coaching	Managing Emotions
50%	**47%**	**12%**	**11%**

A Foundation for Strong Client-Advisor Relationships

Advisors who integrate aspects of behavioral finance into their practice connect with their clients on a different level. Acknowledging the humanness of investing sheds light on emotional barriers to success and reframes the conversation.

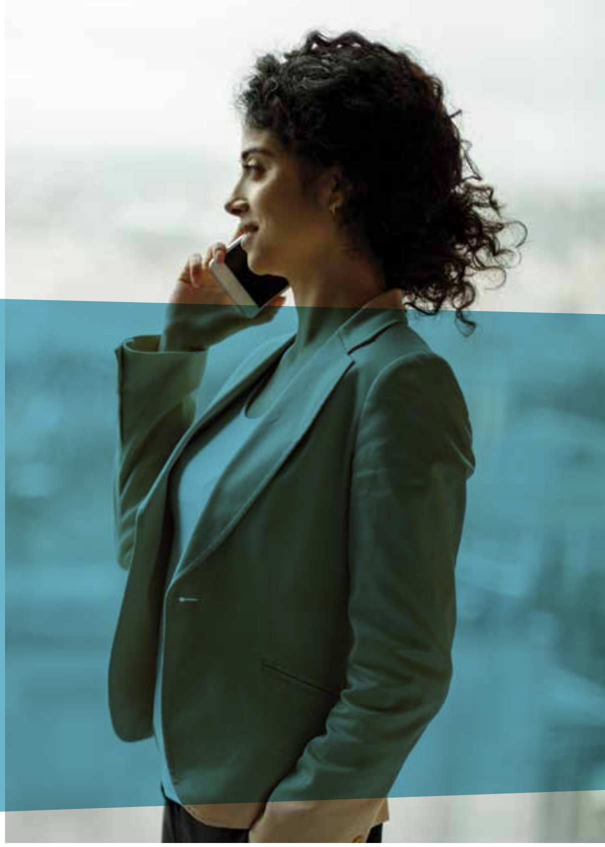
Investors have recently faced even greater uncertainty and loss of control over many aspects of work, life, and health. Increasing uncertainty leads to increasing stress—and a decrease in people's ability to think clearly, manage emotions appropriately, and make sound decisions—and that contributes to even greater difficulty making behavioral changes.[8]

It's also true that financial health can impact physical health, so clients who make financial preparations for future uncertainty are able to reduce the impacts of stress on their quality of life—including impacts on their physical well-being.[8]



Source: think2perform

Advisors who are emotionally attuned to their clients can help navigate the certainty of uncertainty. Applying the precepts of behavioral finance can help advisors understand the following:

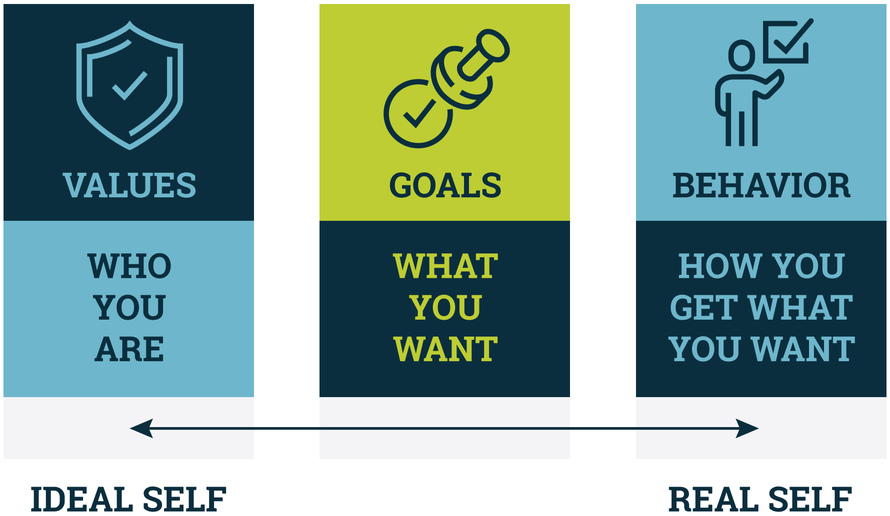


- » Investors, as humans, are not always rational, and decision-making can be affected by both cognitive and emotional biases[6]
- » In general, cognitive biases are easier to overcome than emotional biases[6]
- » Considerations of stress, biases, and behaviors may be used to construct investment portfolios that may help investors more effectively manage their thoughts, feelings, and actions[6]

Using these unique insights can help advisors ask probing questions to get a better grasp on client fears and circumstances and develop more meaningful ways to connect and communicate. This adds intrinsic value and strengthens the client-advisor relationship.

What is perhaps most beneficial, however, is how behavioral finance allows advisors to build portfolios that mitigate the impact of potentially counterproductive, habitual stress- or emotion-based behaviors (e.g., panic-induced selling-low/buying-high cycles).

Finally, behavioral finance gives advisors an opportunity to guide clients to recognize, reflect, reframe, and respond to stressful experiences and circumstances in ways that may lead to better financial outcomes. As a result, clients can also become better able to balance their ideal and real selves and consistently live within their values.



Source: think2perform

As the psychology behind client behaviors and decision-making continues to expand in the financial space, advisors need to rethink the traditional client-advisor relationship dynamic. Structuring a practice that includes aspects of behavioral finance expands opportunities for advisors to connect with clients, and clients will increasingly expect guidance balanced between expertise and their unique needs.

CUNA Mutual Group's Acceleration® value-add series offers a variety of business-building ideas, including the incorporation of behavioral finance advising as a way to enhance your client relationships and differentiate your business. Reach out to your CUNA Mutual Group wholesaler today and ask how you can get started.

For additional behavioral finance resources for you and your clients, visit smartriskcontrol.com or call the CUNA Mutual Group Annuity Solutions Desk at 877.345.GROW (4769), option 1.

SOURCES

[1]American Psychological Association, ***Stress in America™ 2020: A National Mental Health Crisis,*** 2020.

[2]AFCPE, ***Financial Stress Amplified: Data From the COVID-19 Pandemic***, 2021.

[3]Caliente Leadership, ***Impact of Stress on Decision Making,*** May 21, 2020.

[4]think2perform, ***Decision Making and Performance***, undated.

[5]Corporate Finance Institute, ***Behavioral Finance***, undated.

[6]Wells Fargo, ***How Can Emotions Influence Investment Decision-Making?***, March 2020.

[7]Investments & Wealth Institute, ***Executive Summary: 2020 Investor Research***.

[8]think2perform, ***Certainty of Uncertainty***, undated.

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