

# What Your Clients Actually Think

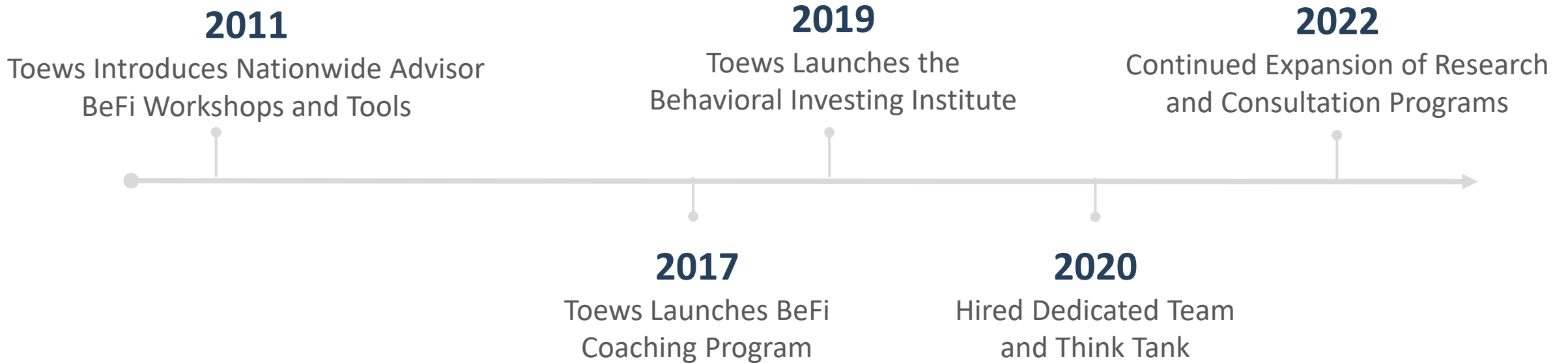


**WHAT INVESTORS FEAR AND WHAT INSPIRES CONFIDENCE**

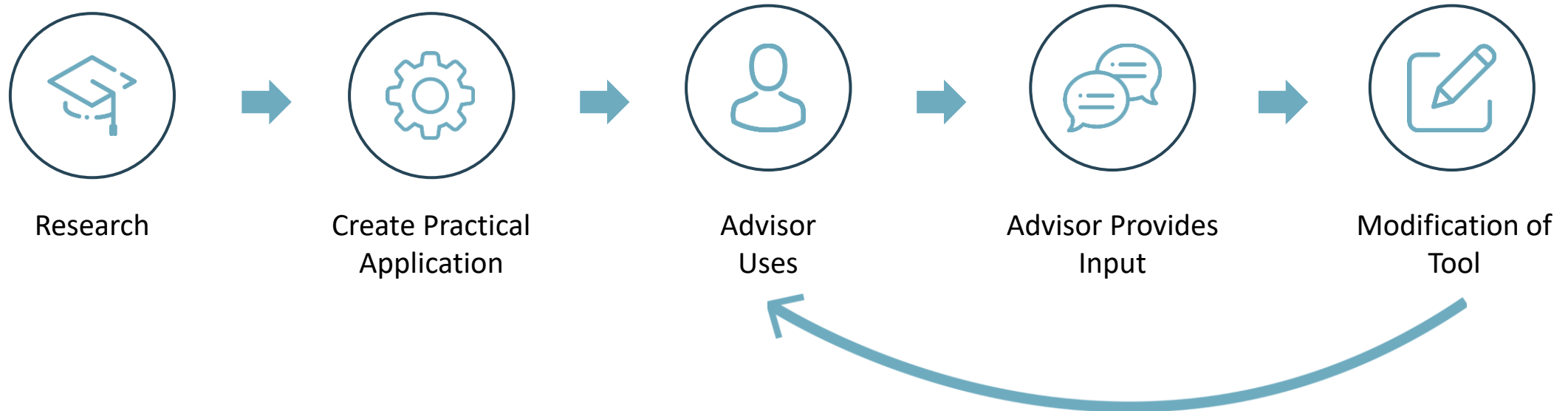
**Dan Kullman**

**Director of Education and Training**

# Behavioral Investing Institute Evolution



# The Scientist Practitioner Model



# Overview

❖ Research done in partnership between



❖ Data gathered from 1,000 US Investors between March 30<sup>th</sup> and April 6<sup>th</sup>.

❖ Respondents Investable Household Assets Breakdown

- 500K – 999.9K = 44%
- \$1 m - \$4.9 m = 44%
- Over \$5 m = 12%

## Investor Primary Motives

- ❖ The primary concern of investors is to not outlive their money.
- ❖ This is the primary reason they hire a financial advisor.

# Fear and Confidence

- ❖ When investors have more confidence that they will not outlive their money there is an increase in...
  - Advisor Loyalty
  - Referring
  
- ❖ When investors are more fearful of outliving their money, there is an increase in...
  - Holding risky assets away from advisor
  - Performance chasing
  - Consideration of hiring a new financial advisor

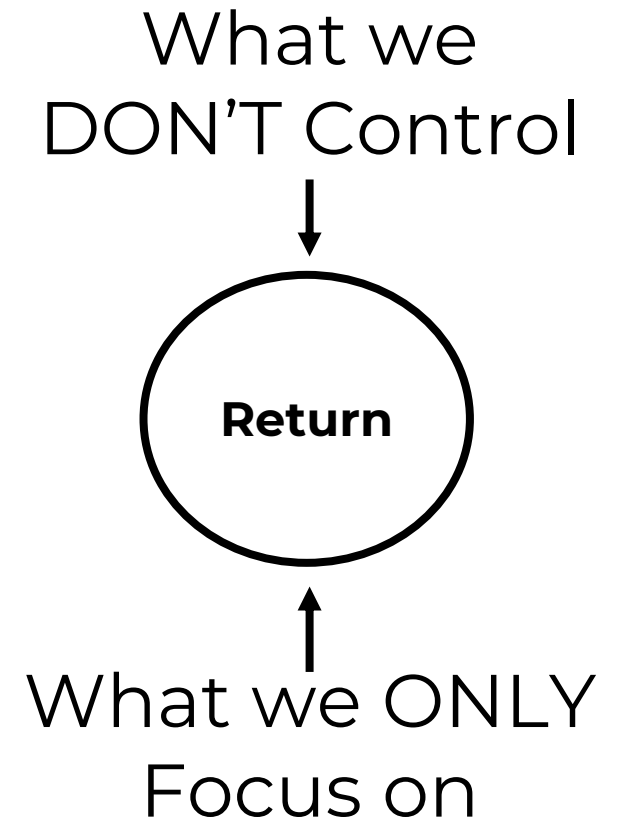
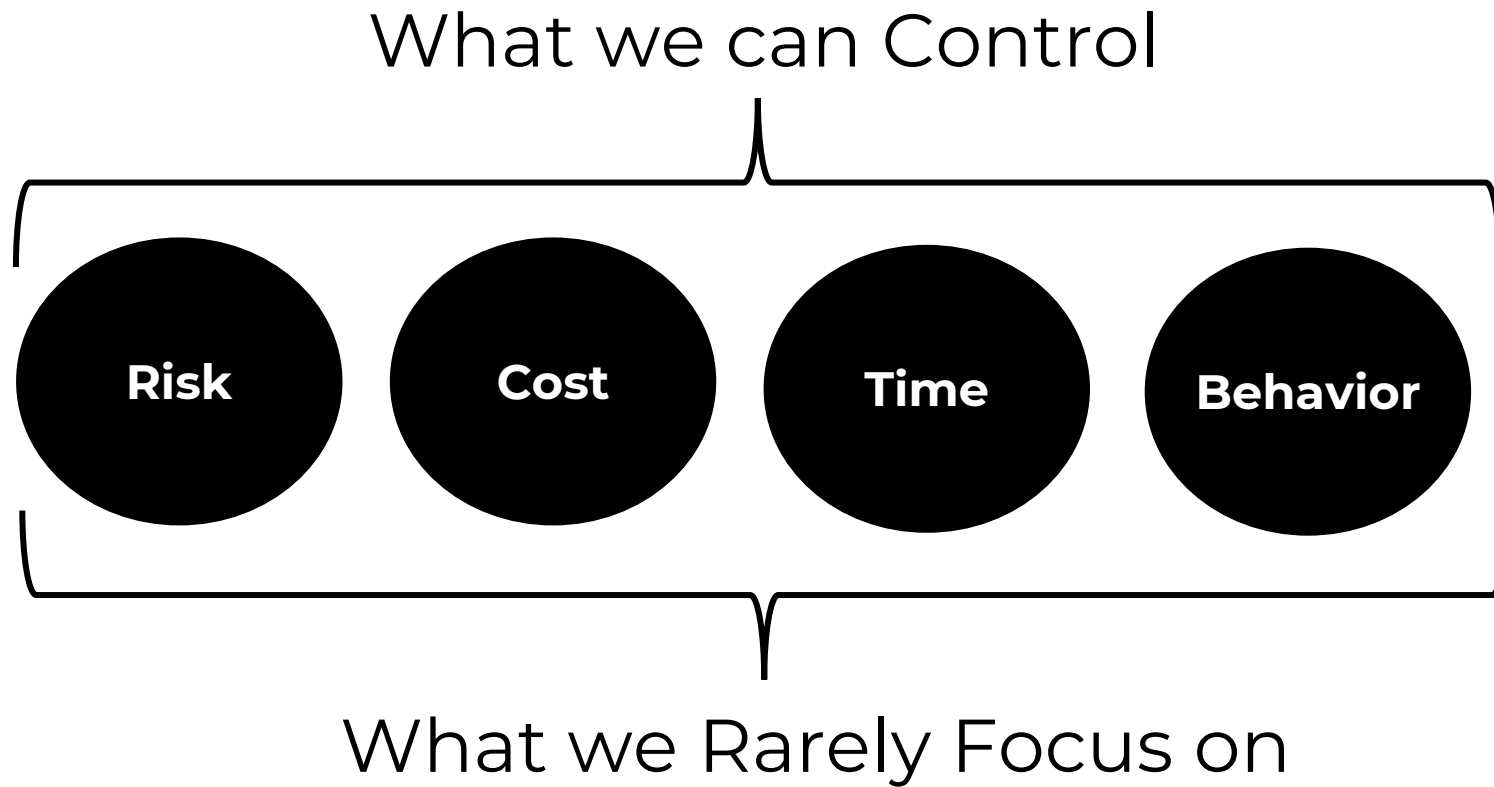
# Plans Increase Confidence

- ❖ Plans must be communicated clearly and understood
- ❖ They need to make investor feel in control of their environment

# What To Do?




# Explain What They Control



## WHAT TO DO - #2

# Don't Avoid Discussing All Market Scenarios

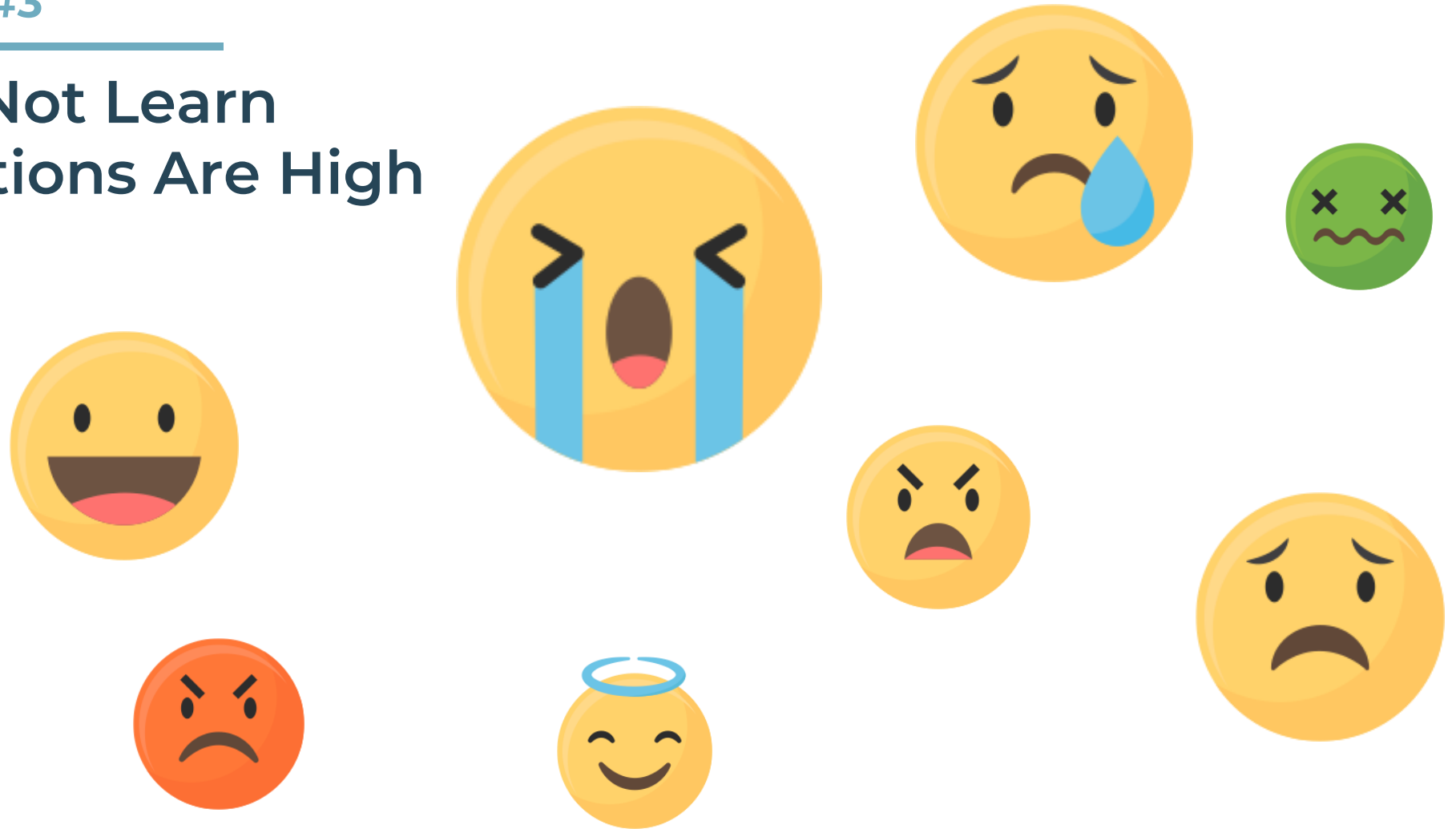


If you Plan for Best Case and Worse Case Scenarios there won't be Worse Case Scenarios

## WHAT TO DO - #3

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# People Do Not Learn When Emotions Are High



## WHAT TO DO - #4

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# Do Not Rely Solely on Risk Tolerance Questionnaires



## WHAT TO DO - #5

# Reconciling Lowering Return Expectation Without Increasing Fear of Outliving Money

	LOWER LOSS DEVIATION PORTFOLIO	HIGHER AVERAGE RETURN PORTFOLIO
<b>STARTING VALUE</b>	<b>\$1,000,000</b>	<b>\$1,000,000</b>
Year 1	5%	7%
Year 2	7%	19%
Year 3	8%	15%
Year 4	-6%	-38%
Year 5	8%	22%
Year 6	7%	18%
Year 7	11%	38%
Year 8	9%	14%
Year 9	-8%	-45%
Year 10	7%	27%
<b>Ending Value</b>	<b>\$1,569,832</b>	<b>\$1,436,192</b>
<b>Average Return</b>	<b>5%</b>	<b>8%</b>

This chart is for illustrative purposes only and is not representative of any specific investment or mix of investments. \*Loss deviation is the measure of dispersion about the average which depicts how widely negative returns vary during the investment period. It has been calculated on a yearly basis and should not be considered in isolation since it only measures the volatility of negative performance.

# Market Scenario Planning & Response

Creating intellectual and emotional congruence

**Systems approach to  
decision making**

**IF...**  
**THEN...**

# Investment Owner's Manual

Planning And Response For Market Scenarios

# Table of Contents



1. **Significant Losses**
2. **Long Periods Of Low Or No Returns**
3. **Out Of Favor Asset Or Investment Style**
4. **Asset Bubbles**
5. **Financial Noise**



# Six Step Planning And Response Decision Architecture



1. **Identify Challenge**



2. **Portfolio Readiness**



3. **Recognize History**



4. **Understand Behavioral Temptation**



5. **Re-framing The Challenge**



6. **Action And Response**

# Significant Losses

## Planning And Response



### Step 1 Of 6: Identify Challenge

“Loss in portfolio”



### Step 2 Of 6: Portfolio Readiness

1. Part of equity portfolio is hedged to help manage risk of declines
2. Have a fixed income strategy without correlation to stocks

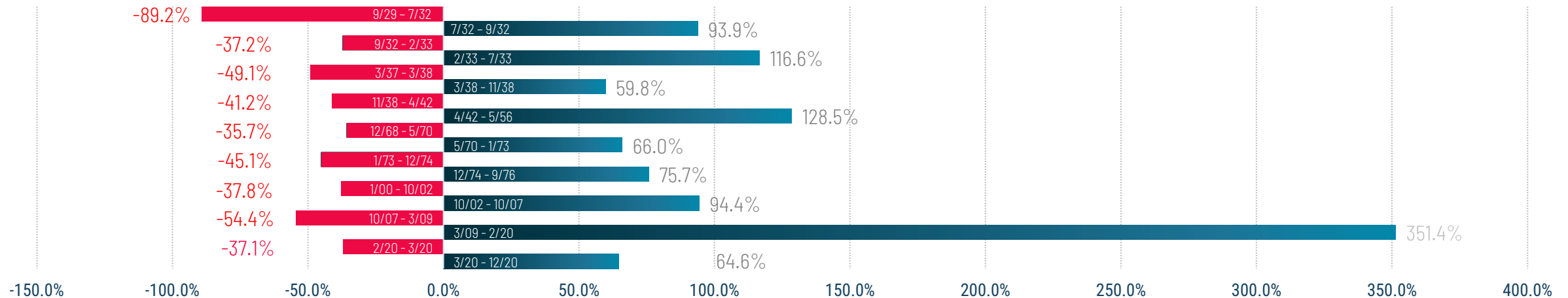
# Significant Losses

## Planning And Response



### Step 3 Of 6: Recognize History

#### PAST BEAR MARKETS AND RECOVERIES



The more extreme market declines become, the more extreme following market actions may be.

Eight prior instances of declines of 30% or more in the Dow Jones Industrial Average Index, average rebound of 91%\*. Average duration of 2.1 years\*.

**Past performance is no guarantee of future results.** Source of Data: Bloomberg, accessed 02/16/21. The Dow Jones Industrial Average Index is an unmanaged index generally representative of the U.S. bond market. It is not possible to invest directly in an index.

# Significant Losses

## Planning And Response



### **Step 4 Of 6: Understand Behavioral Temptation**

“Many investors want to sell at bottom”



### **Step 5 Of 6: Re-frame The Challenge**

“Black Friday sale”

# Significant Losses

## Planning And Response



### Step 6 Of 6: Action and Response

#### Response

Embrace potential  
Opportunity



#### Action

Systematically rebalance  
portfolio into assets with  
steep declines and take  
advantage of “Black Friday”  
sales prices

Additional Notes

# Long Periods Of Low Or No Returns

## Planning And Response



### **Step 1 Of 6: Identify Challenge**

No growth



### **Step 2 Of 6: Portfolio Readiness**

Adaptive fixed income still generating income

# Long Periods Of Low Or No Returns

## Planning And Response



### Step 3 Of 6: Recognize History

There is a **23%** chance any **5 Year Period** will have an S&P 500 Index average return of under **3% per year**.

**The average gain over the next 5 years has been 90%.**

**Past performance is no guarantee future results.** It is not possible to invest directly in an index. Sources of Data: Global Financial Data from 12/31/1830 -12/29/2006 and Bloomberg from 12/30/2006-12/31/2017. As of 5/31/2018. This is designed to show the relationship between market cycles, but there can be no guarantee that clients will receive this level of return.

# Long Periods Of Low Or No Returns

## Planning And Response



### Step 4 Of 6: Understand Behavioral Temptation

Many investors want to change their portfolio and buy into what has done best lately which may be a bubble to “catch up”



### Step 5 Of 6: Re-frame The Challenge

“Market springs are being compressed”



# Long Periods Of Low Or No Returns

## Planning And Response



### Step 6 Of 6: Action and Response

#### Response

Practice Rigorous Patience



#### Action

Monitor and Maintain  
Portfolio Blend

### Additional Notes

# OUT OF FAVOR ASSET OR INVESTMENT STYLE

## PLANNING AND RESPONSE



### **Step 1 Of 6: Identify Challenge**

A component of the portfolio not performing as well as another



### **Step 2 Of 6: Portfolio Readiness**

Portfolio components not designed to move in tandem

# OUT OF FAVOR ASSET OR INVESTMENT STYLE PLANNING AND RESPONSE



## Step 3 Of 6: Recognize History

### S&P Persistence Scorecard

1. Twice a year the S&P does a **Persistence Scorecard**
2. U.S. Equity Funds are grouped into Large Cap, Mid Cap, Small Cap and Multi-Cap
3. Based on previous 5 year Annualized returns they are ranked into quartiles.
4. 5 Years later almost **NONE** of those same funds were ranked in the 1st quartile based on the previous 5 Year Performance.

Liu, B., Preston, H., & Soe, A. (2020). Does Past Performance Matter? The Persistence Scorecard. Does Past Performance Matter? The Persistence Scorecard. New York, NY: S&P Dow Jones Indices.

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# OUT OF FAVOR ASSET OR INVESTMENT STYLE

## PLANNING AND RESPONSE



### **Step 4 Of 6: Understand Behavioral Temptation**

We want everything to only go up in value



### **Step 5 Of 6: Re-frame The Challenge**

“Opportunity to buy more of out of favor before it becomes in favor”

# OUT OF FAVOR ASSET OR INVESTMENT STYLE

## PLANNING AND RESPONSE



### Step 6 Of 6: Action and Response

#### Response

Prepare for the potential that out of favor asset may come into favor



#### Action

Realize profits from in favor assets and transfer them to out of favor assets:  
Rebalance

#### Additional Notes

# Asset Bubbles

## Planning And Response



### **Step 1 Of 6: Identify Challenge**

“Fear of missing out”



### **Step 2 Of 6: Portfolio Readiness**

“Because of diversification, its likely to have exposure already”

# Asset Bubbles

## Planning And Response



### Step 3 Of 6: Recognize History

#### TECH

*(NASDAQ Index)*

6/24/1994 - 3/10/2000

**+627.7%**

3/10/2000 - 10/9/2002

**-77.9%**

#### REAL ESTATE

*(S&P 500 Index)*

10/9/2002 - 7/23/2007

**+98.5%**

7/23/2007 - 3/29/2009

**-56.1%**

#### JAPAN

*(Nikkei Index)*

1/6/1971 - 12/27/1989

**+1863.7%**

12/27/1989 - 4/28/2003

**-77.9%**

Source of Data: Bloomberg LP, accessed on 6/26/2020. The S&P 500 Index is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies. The Nikkei is Japan's leading stock index comprised of the country's top 225 blue-chip stocks. The Nasdaq Composite Index is the market capitalization-weighted index of over 2,500 common equities listed on the Nasdaq stock exchange.

# Asset Bubbles

## Planning And Response



### **Step 4 Of 6: Understand Behavioral Temptation**

“Most investors will want to buy into bubble”



### **Step 5 Of 6: Re-frame The Challenge**

“When the bubble pops you will either have minimal or no exposure”



# Asset Bubbles

## Planning And Response



### Step 6 Of 6: Action and Response

#### Response

Disengage from the mania of the crowd.



#### Action

Rebalance away from bubble assets.

### Additional Notes

# Financial Noise

## Planning And Response



### Step 1 Of 6: Identify Challenge

“Don’t know what to do with so much information?”



### Step 2 Of 6: Portfolio Readiness

“We have an investment plan prepared for all scenarios”

# Financial Noise

## Planning And Response



### Step 3 Of 6: Recognize History

#### Study:

The effect of myopia and loss aversion on risk taking: an experimental test.

#### Conclusion:

The investors who viewed portfolios **more frequently** took the least risk and **earned the least money**.

Thaler, R. H., Tversky, A., Kahneman, D., & Schwartz, A. (1997). *The Quarterly Journal of Economics*, 112(2), 647-661. doi:10.1162/003355397555226

# Financial Noise

## Planning And Response



### **Step 4 Of 6: Understand Behavioral Temptation**

“We want to act on information”



### **Step 5 Of 6: Re-frame The Challenge**

“We’ve created a scenario planning and response”

# Financial Noise

## Planning And Response



### Step 6 Of 6: Action and Response

#### Response

Maintain a low noise environment.



#### Action

Review portfolios in the context of market changes and progress toward meeting goals.

#### Additional Notes

# Affirmation

**This document serves as our planned action and response to market scenarios.**

1. Significant Losses = Embrace Potential Opportunity
2. Long Periods of Low or No Returns = Practice Rigorous Patience
3. Out of Favor Asset of Investment Style = Anticipate that out of favor asset may come into favor
4. Asset Bubbles = Disengage from the mania of the crowd
5. Financial Noise = Maintain a low noise environment

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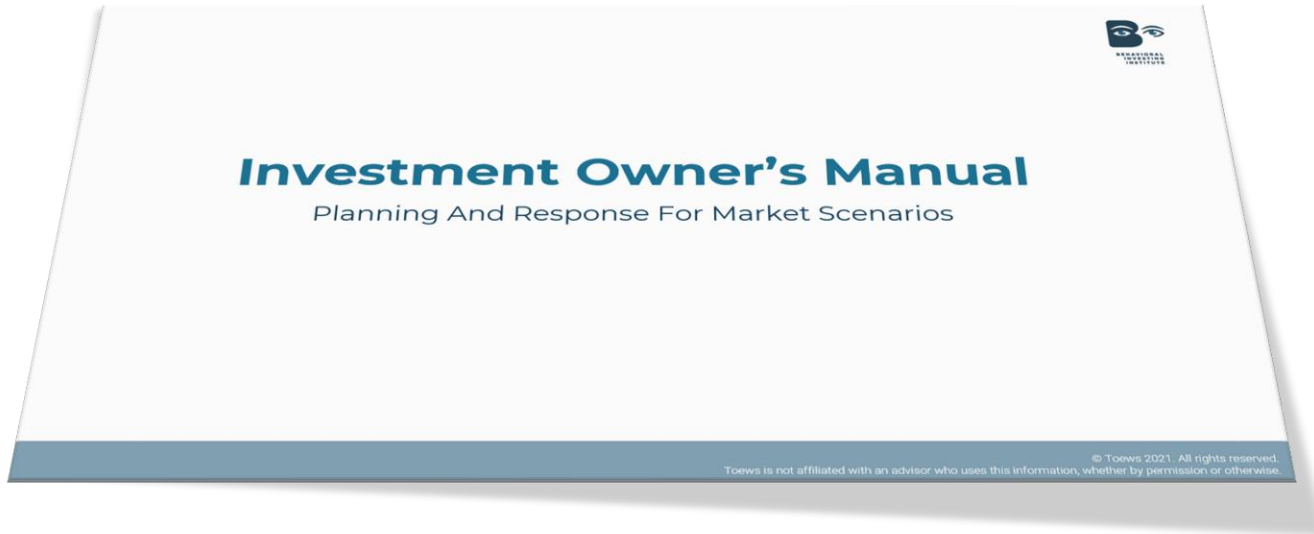
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*\*I understand that my signature above in no way requires me to follow through with the conclusion and prepared responses and actions. They serve only as suggested investor response plans and are nonbinding.*

# BEHAVIORAL INVESTING INSTITUTE

## ADVISOR PRACTICE MANAGEMENT SUPPORT TEAM



For A Complimentary White Labeled  
Investment Owner's Manual and  
Consultation email request to  
**Blake@BIIcoaching.com**



**Blake Jordan**  
Practice Management &  
Communications  
Consultant



**Greg Brunck**  
Portfolio Design  
Consultant

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