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Clark Capital Management Group

NavigatorInsights

Personalized Risk Management

Helping Clients Make Smarter Decisions about Their Money

In a 2014 survey conducted by CEG Worldwide and the Money Management Institute[1], affluent clients ranked the top five services they want from a financial advisor. Topping the list at #1 was to help them "make smart decisions with their money."

By shifting financial conversations to help clients focus on purpose and goals, our industry can help clients make more meaningful – and smarter – decisions about their money. We believe that utilizing a highly personalized approach to the financial process is key to helping clients focus on outcomes. This personalized approach incorporates three elements: a personalized financial plan, supported by personalized investments and personalized risk management. This process, with an emphasis on personalized risk management, can help clients feel more "invested" in their financial future.

In this article, we'll examine why clients can be hard-wired to make irrational decisions about their own money and how advisors can help.

Bear Market or Grizzly Bear? Same Response – Run Away!

Ironically, clients would have the same emotional response to a bear market as they would have to an actual bear chasing them in the woods. In either scenario, adrenaline spikes, areas of the brain responsible for rational decision-making are reduced, and the body turns on systems that can help a person run away from danger and preserve their safety.

The ability to conserve energy from systems that aren't absolutely necessary in favor of contributing energy to systems that can help a person run away from danger made a lot of sense to our ancestors on the plains of the Sahara thousands of years ago. Unfortunately, those same systems can wreak havoc on our decision-making capabilities, and even our health, if they aren't kept in check.

Clients' Brains on Stress: Emotional and Forgetful

We're all the benefactors, and victims, of the way our brains have evolved.

The prefrontal cortex and amygdala are two areas of the brain that affect our emotions and decision-making capabilities. The amygdala controls emotions and the prefrontal cortex is responsible for rational thought. Think of it this way: if you're taking the bar exam to become a lawyer, you'll rely on your prefrontal cortex to help drive your reasoning capabilities and to help you arrive at the most likely answers.

If you're camping and suddenly encounter a bear, the amygdala kicks in sending much-needed hormones to key areas of the body to help you fend off or run away from the predator. At the same time, the brain takes energy from other systems that aren't as necessary — namely rational thought, memory, and reasoning.

Does Stress Make You Stupid?

When we're stressed, memory becomes distorted and emotions spike. Electrical signals in the brain associated with the formation of factual memories weaken while areas in the brain associated with emotion strengthen.

According to behavioral consultant Christy Matta, M.A., "Our findings suggest that the growing dominance of amygdalar activity over the hippocampus during and even after chronic stress may contribute to the enhanced emotional symptoms, alongside impaired cognitive function, seen in stress-related psychiatric disorders."[2]

When a market takes a downward turn or the nightly news evokes a state of hysteria, clients may experience a loss of cognitive function and be tempted to make irrational decisions.

Using Personalized Risk Management to Help Reduce the Stress of Investing

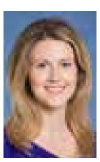
Just as the markets go up and down, investors' appetite for risk goes up and down. Changes in investor behavior are documented by money flows into equities during the late stages of a bull market and out of equities during the late stages of a bear market. In both cases, irrational behavior is driven by fear and greed.

A personalized risk management approach will adjust and adapt to the changing markets based upon the desired outcome or goal of the client. As investment advisors, it may be time to take a look at the current bull market and talk to clients about taking some risk off the table. Here are some suggestions for using personalized risk management to help ward off clients' financial stress:

- Use personal benchmarks to help clients stay focused on their needs, not just market results.
- Focus on the outcomes clients wish to achieve and target investments to those outcomes.
- When appropriate, incorporate downside hedging to protect clients' downside risk exposure.

1. "Winning the Allegiance of Top Financial Advisors." CEG Worldwide,2014.

2. Matta, Christy: "Our Brain on Stress: Forgetful & Emotional." Psych Central, 2013. (Retrieved on February 18, 2015, from http://psychcentral.com/blog/archives/2013/05/06/our-brain-on-stress-forgetful-emotional/)



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