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How to overcome subconscious biases that interfere with financial decision-making

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THE GLOBE AND MAIL
PUBLISHED AUGUST 01, 2023

See the column on The Globe and Mail's website here. (Subscription required)

When making investment decisions, it's easy to get caught up in data, macroeconomics, and financial markets. However, an often-overlooked aspect is the profound impact of psychological factors.

These deep-rooted beliefs, emotions and personal values can lead even experienced investors to make impulsive choices that derail long-term financial objectives.

Wealth advisors have a unique opportunity to work with clients to identify their blind spots and explore potential biases or triggers. By investing the time to understand and acknowledge the complexities of a client's beliefs and experiences, advisors can play a vital role in safeguarding their long-term financial goals.

While advisors are entrusted with prioritizing clients' best interests and informing them about the potential consequences of financial choices, the most effective ones will address clients' psychology about money head-on, taking a well-rounded approach that considers both the rational and emotional aspects of investing.

Every client is unique, and embedded investment experiences, childhood scarcity or abundance, culture, and values, will influence their financial decision-making. By cultivating deep relationships, advisors can guide clients through delicate conversations and provide personalized guidance for their specific circumstances.

Uncover common biases

There are many subconscious biases that can interfere with the sound financial decision-making process.

For example, the disposition effect occurs when an investor may feel they sold their profitable investment too early, or when they hold onto losing investments for too long. Similarly, loss aversion may occur when investors worry more about avoiding losses than acquiring gains of the same value, which may lead to missed growth opportunities. Anchoring bias occurs when a client makes a quick decision based on the first piece of information, hindering their ability to do thorough research and due diligence.

Biased-based investing often makes headlines, most recently with the cryptocurrency boom. Many investors, driven by the fear of missing out on rising prices and the next big thing, jumped into the asset class without a strategic approach. In many cases, this impulsive action resulted in substantial losses, highlighting the consequences of succumbing to biases.

Avoiding common biases is possible through a careful and proactive approach to savings, investing, paying off debt and living within one's means – all of which should be discussed frequently with an advisor. They can build a personalized financial plan that incorporates strategies for optimizing wealth in favourable times while also preparing hedges for, and role playing in advance of, unpredictable situations.

How to address emotional ties

To support clients who exhibit a strong aversion to losses, or harbour concerns about investing money with emotional ties, such as an inheritance, advisors can employ valuable techniques like a lifeboat drill or volatility life vest exercise. These involve stress testing a client's investments or general financial well-being by playing out difficult scenarios such as a market downturn, job loss, or health scare, regularly, and in advance of the event occurring.

Using past tense is important, as clients tend to be more receptive to role-playing challenges that have already occurred rather than discussing the possibility of them happening in the future. For example, "If you passed away yesterday" is often better received than "If you passed away tomorrow," which can cause people to panic. Asking clients of their favourite non-perishable goods that they would stock up on sale at the supermarket and reminding them of the conversation later puts things in perspective. Drawing real-life analogies that clients can associate with often makes the experience more tangible and relatable.

By creating a plan for potential worst-case scenarios, clients can take comfort in knowing they're prepared for these situations, which can decrease the impulse to act upon feelings of fear.

Discover invisible influences

While supporting clients on the path to financial success, advisors should encourage them to embark on a journey of self-discovery. That could be as simple as asking whether clients grew up talking about money around the dinner table. This simple question could reveal key insights into their financial management skills as children who had frequent and positive conversations with their parents about money are more likely to exhibit responsible financial behaviours and have higher savings rates.

For someone who achieved financial liberation through their academic and professional accomplishments, scholarships or sponsorship, their children's education savings may be the primary financial priority. In contrast, someone who equated family time with travel, shopping and leisure may find saving for longer-term goals like retirement challenging.

Viewing one's past experiences with compassion and self-awareness can shine a light on the impact of motivations shaping their financial future.

By understanding the social forces that have shaped them, advisors can support clients to feel more empowered and make informed decisions that align with their objectives within the context of their values.

Social relationships and cultural norms can also affect clients' financial goals and aspirations in unique ways.

In some cultures, it's common for individuals to take on the responsibility of supporting family members financially. That may mean supporting aging parents financially, paying siblings' tuition, or providing financial assistance until employment is found. While it can be a source of pride, or even guilt, it can also pose serious challenges in saving for their own financial goals.

Guiding through emotions

As clients navigate their introspective journeys and examine the influences that shape their financial decisions, advisors can act as a support system, providing empathy and a safe space to share underlying fears and motivations that guide decision-making.

They can also point clients in the direction of additional support and educational resources that explore the connection between psychology and finances further. Advisors can remind clients of the importance of practices such as meditation, healthy sleeping habits, and regular exercise, which can enhance overall well-being, increase self-esteem, and reduce anxiety and stress.

Most important, great advisors should act as valuable coaches, asking insightful questions, encouraging clients to express themselves, and motivating them to delve into their psychology of money. By facilitating this process, they can prompt clients to develop greater confidence, both personally and financially, and prepare them for long-term prosperity.

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