



2021

INVESTOR BEHAVIOR IN A MARKET CRISIS



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Research conducted by Absolute Engagement.
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The Perception Gap

Clients often make investment decisions that run contrary to reaching the goals they have set. And we know that they do that because they are human.

Tackling this very human challenge means helping clients both identify and understand the behaviors that may be getting in the way of reaching their goals. To achieve that, advisors also will need to test their own assumptions and ensure they are providing exactly the right support based on client perceptions.

To support advisors in understanding and managing client behaviors, Behavioral Investing Institute partnered with Investments & Wealth Institute and Absolute Engagement to conduct in-depth research among both advisors and investors. This report summarizes the key findings of that research, incorporating input from 750 high-net-worth investors and 200 financial advisors.

Data was gathered via online surveys during April and May 2021. Profile information for both advisors and investors can be found in the appendix.

The research highlights two important points:

- Clients may not make the best decisions if they are not fully informed. The data shows that investor knowledge is both imperfect and, at times, overstated.
- Advisors may not provide the support that clients need if they do not understand client perceptions. The data shows a disconnect between advisor and client perceptions.

This report highlights the disconnects between investors and advisors as a starting point in bridging those gaps.

Perception is Reality

Only history can tell us, with accuracy, how investors will react in response to different market conditions. Understanding how clients might respond in the future is, of course, far more difficult. As human beings, we tend to forget the pain of the past. As a result, we may overestimate our ability to withstand pain in the future.

When it comes to the markets, the faulty memories of investors may cause them to make decisions that are not in their best interest. And it's equally important for advisors to understand exactly how investors are thinking.

For that reason, we believe it's important to understand two forms of perception:

- **Investor perceptions.** We need to understand what clients believe they will do in the face of specific challenges, such as market declines, a stock market bubble, or inflation, to identify potential behavioral traps.
- **Advisor perceptions.** We need to understand what advisors believe clients are thinking or feeling, to guard against the potential that those faulty assumptions may be driving the advice provided.

	Investors: To what extent do you agree with the following statements?	Advisors: To what extent do you think your clients would agree with the following statements about their own behavior?	Advisors: To what extent do you think your clients experience these behaviors?
	Percentage who "somewhat or completely agree" with the statement		
I am tempted to sell stocks when markets are going down.	29%	60%	68%
I feel impatient and want to make changes in my portfolio during periods of no or low growth.	31%	60%	63%
I want to sell the strategies that are not doing well compared to other strategies in my portfolio.	42%	67%	71%
I worry about missing out on gains and want to buy the strategy that is rising the fastest.	37%	52%	65%
I get impatient with strategies that have lower returns and want to exchange them for strategies that have higher returns.	34%	54%	68%
I don't believe that inflation and rising interest rates will impact my portfolio.	29%	25%	18%

When it comes to overall investment behaviors, there are some significant gaps between how investors believe they will behave and how advisors believe clients will behave.

- Investors are dramatically less likely than advisors to believe they will respond negatively to specific market conditions.
- Advisors overstate how clients perceive their own reactions. They are much more likely to believe that investors will exhibit negative behaviors.

The most significant gaps between how investors view their own behavior and how advisors view investor behavior relate to the following:

- The temptation to sell stock when markets are going down.
- Feelings of impatience with strategies with lower returns and a desire to exchange them for strategies with higher returns.
- Feelings of impatience and a desire to make changes in the portfolio during periods of no or low growth.

Investor Knowledge

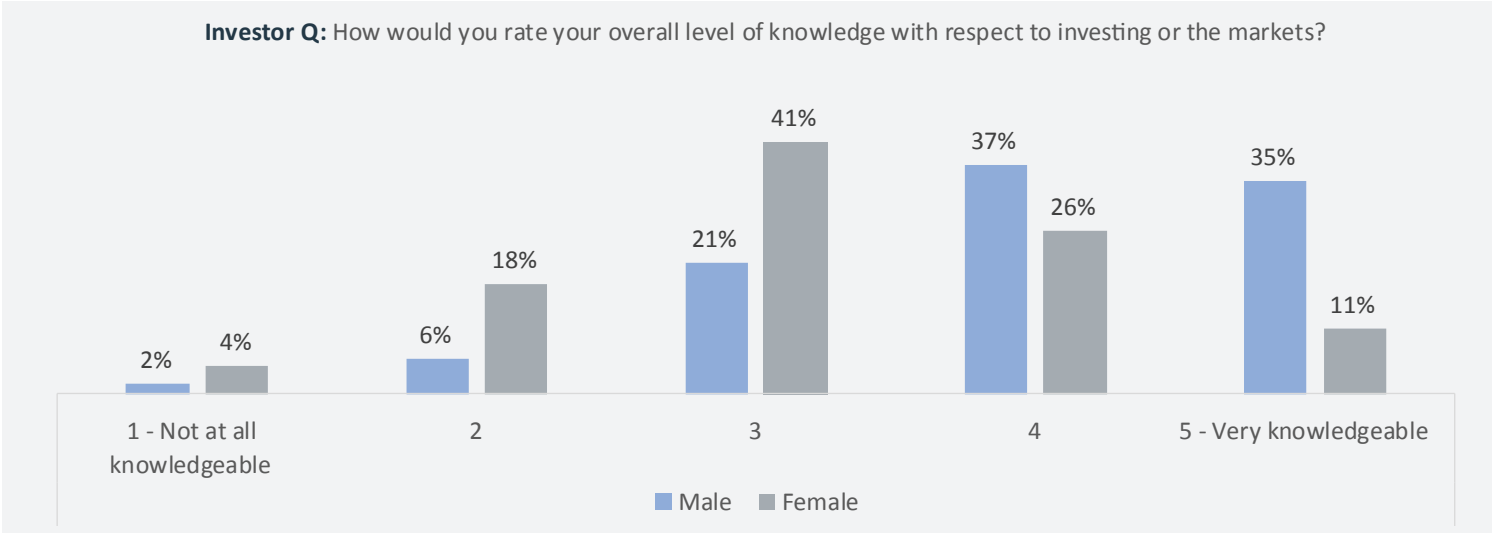
It is accepted wisdom that our level of knowledge—or our perceived level of knowledge—with investing or the markets will impact decision making. Fifty-five percent of investors rate themselves as “somewhat knowledgeable” or “very knowledgeable” regarding investing or the markets.

Investor Q: How would you rate your overall level of knowledge with respect to investing or the markets?

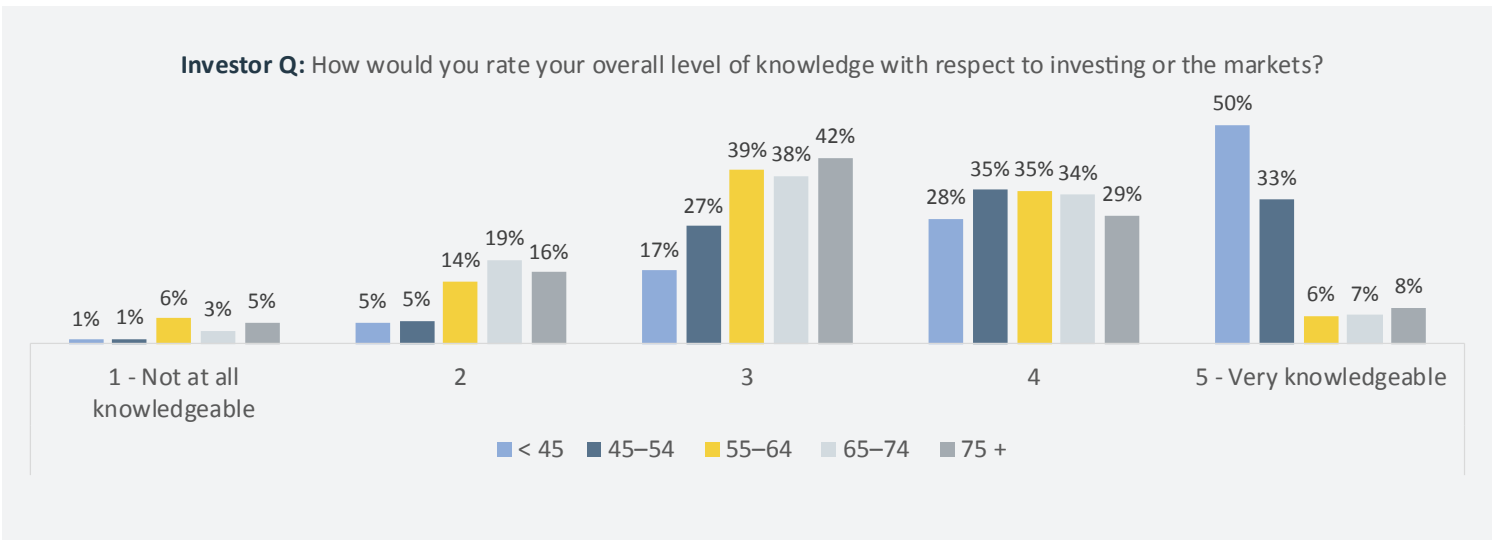
1 – Not at all knowledgeable	3%
2	11%
3	31%
4	32%
5 – Very knowledgeable	23%

The averages, in this case, can be misleading because self-perceived knowledge changes significantly across client segments. There are important differences based on gender, age, and wealth, and those differences may impact decision-making.

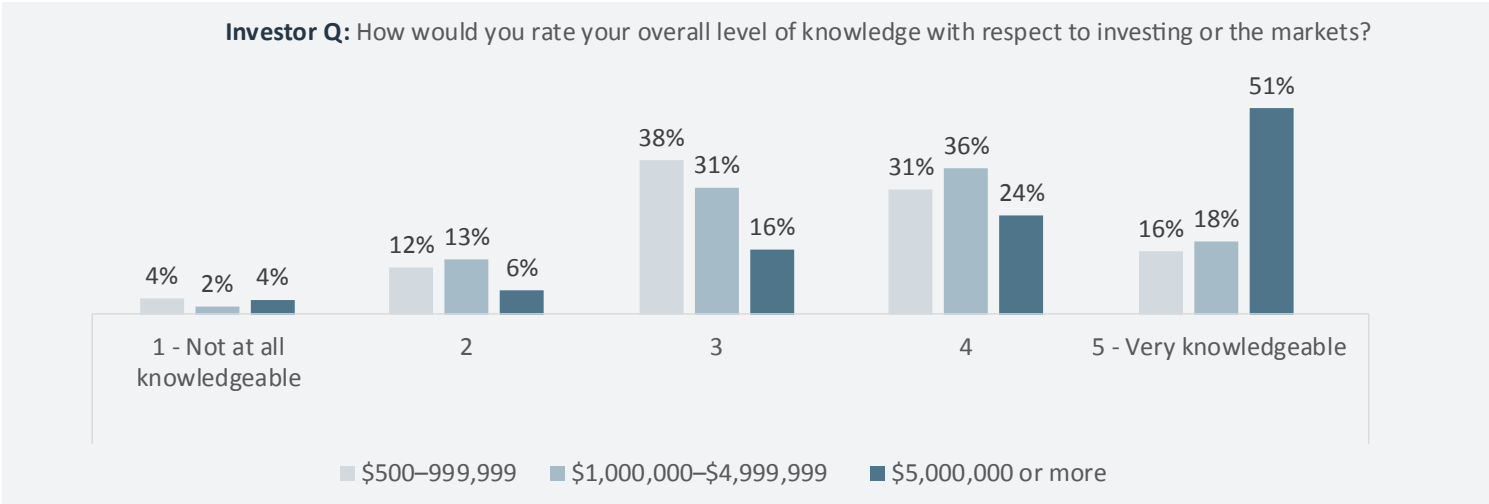
Women tend to rate their investment knowledge as lower.



Younger clients tend to rate their knowledge as higher.



Wealthier clients tend to rate their investment knowledge as higher.



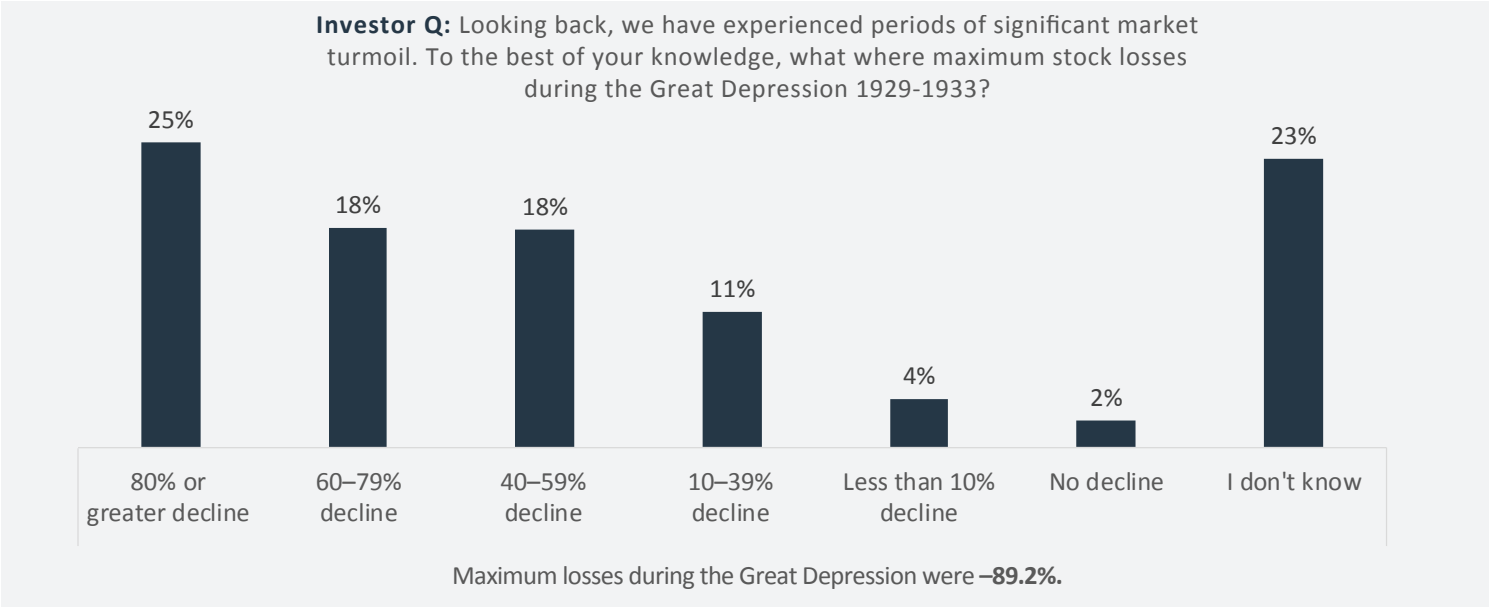
Looking Back: Understanding Losses

Self-perceived knowledge can, of course, be wrong. For example, we know that investor “knowledge” is imperfect when it comes to recalling maximum stock losses during specific times in history.

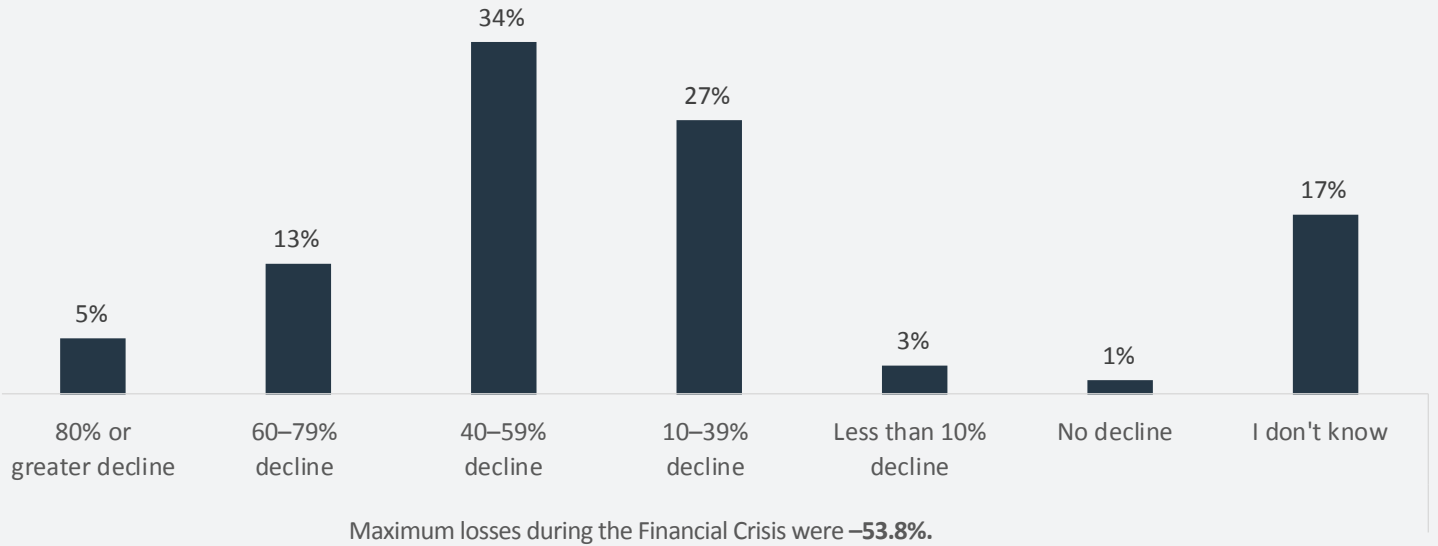
Time Period	Percentage of investors who indicated they can recall maximum stock losses during this period	Percentage of investors who accurately recalled maximum stock losses during this period
The Great Depression (1929–1933)	77%	25%
The Financial Crisis (2008–2009)	83%	~34%
The Global Pandemic (since March 2020)	83%	~28%
~ Approximately		

The charts below show the range of understanding—or lack of understanding—of maximum losses during the periods identified in the previous table. Several things are clear:

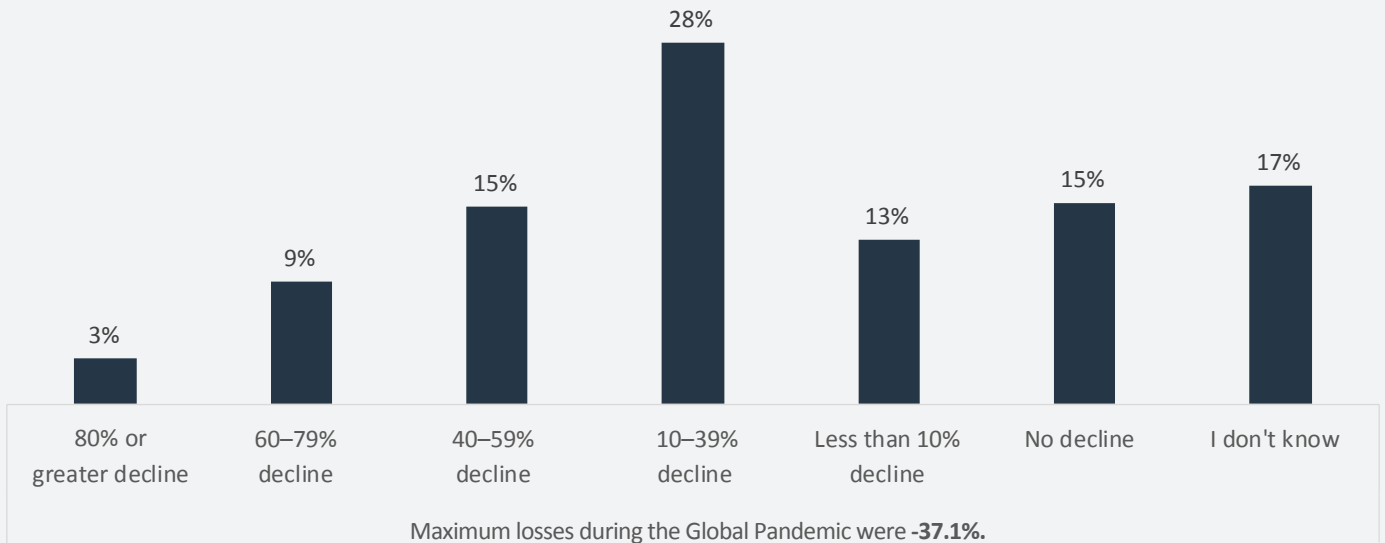
- Perceived understanding of losses is lower for periods of time that are considerably further away, such as the Great Depression.
- There is a significant range of responses. That is, when clients are wrong, they can be wrong to a significant degree.
- Even during recent periods of uncertainty, there is a lack of understanding of maximum losses.



Investor Q: Looking back, we have experienced periods of significant market turmoil. To the best of your knowledge, what were maximum stock losses during the Financial Crisis of 2008-2009?



Investor Q: Looking back, we have experienced periods of significant market turmoil. To the best of your knowledge, what were maximum stock losses during the Global Pandemic?



Women, older clients, and clients with less wealth are consistently more likely to respond “I don’t know” on questions related to maximum losses. This reflects their self-perception that knowledge is lower.

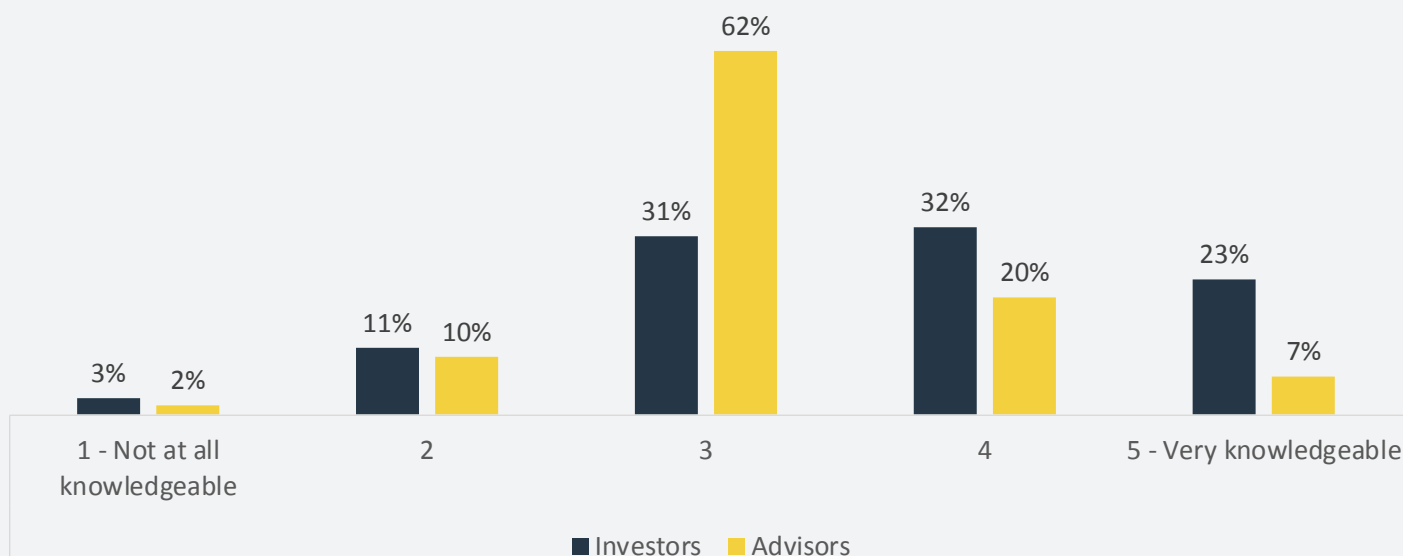
The Knowledge Disconnect

Advisors tend to be less optimistic about investor knowledge, and they may, in fact, be more realistic. However, advisors may not fully realize the extent of the difference between their perceptions and those of clients. They believe clients will rate their level of knowledge even lower than they do.

Three-quarters of advisors believe that client investment knowledge is moderate to low, compared to 45 percent of investors.

Investor Q: How would you rate your overall level of knowledge with respect to investing or the markets?

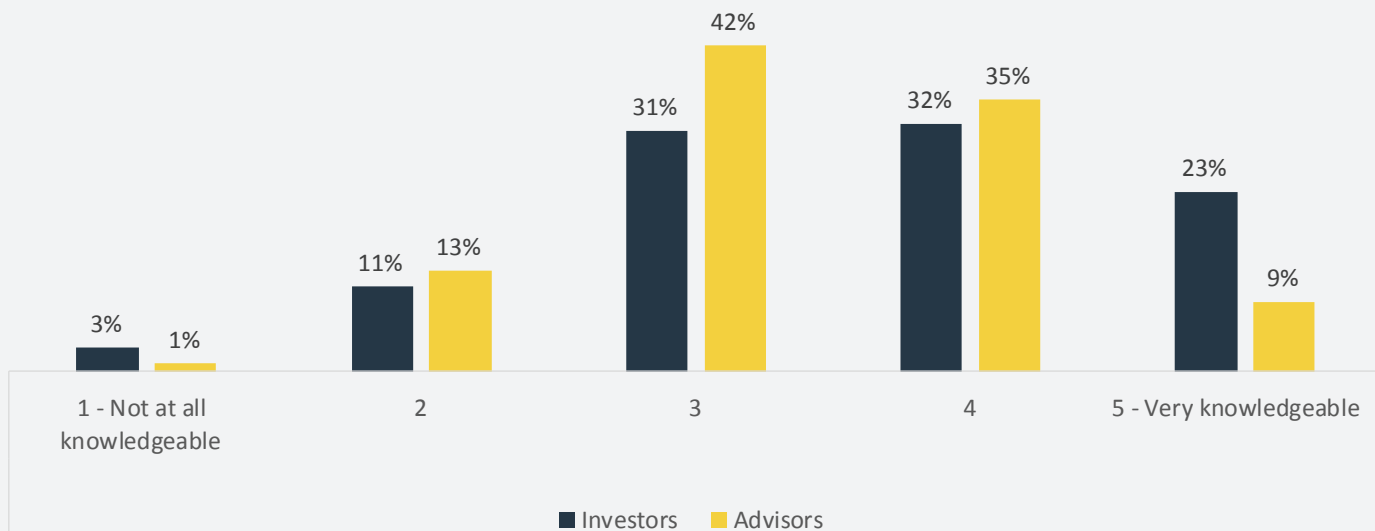
Advisor Q: How would you rate your average client's level of knowledge with respect to investing or the markets?



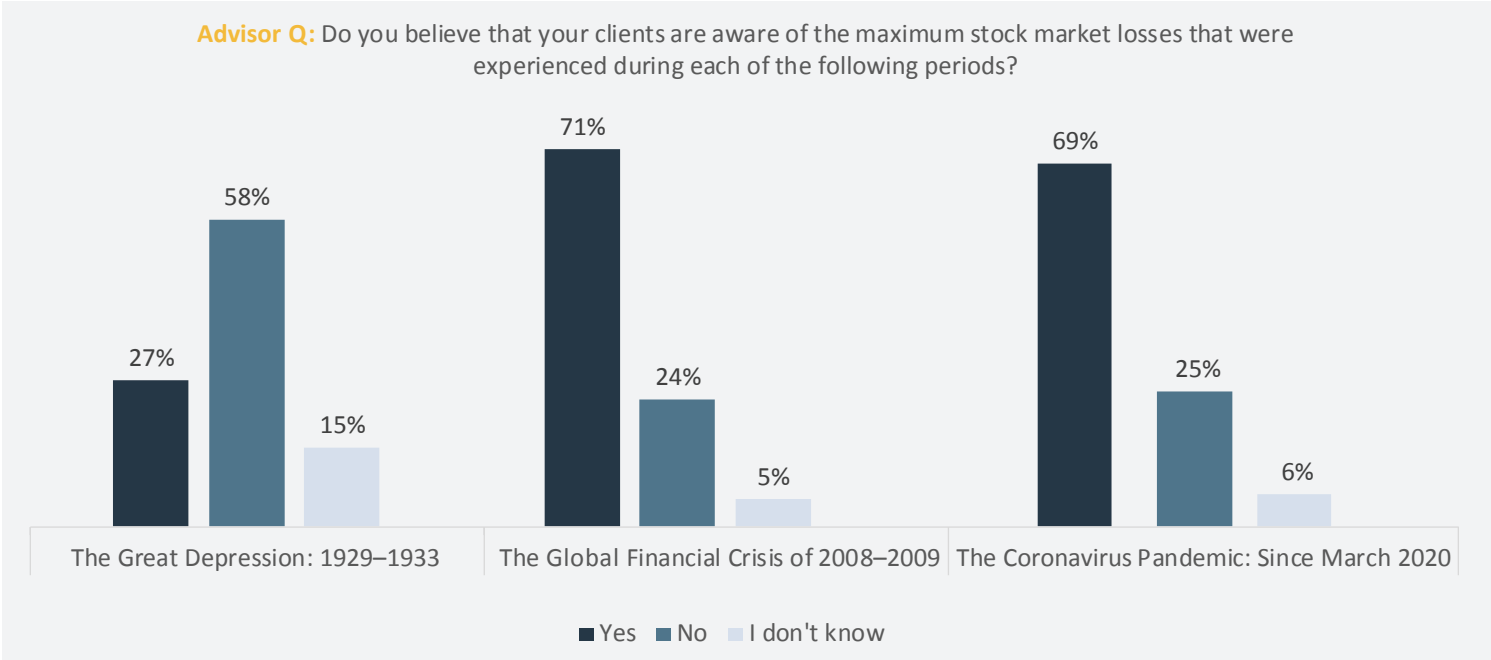
Fifty-six percent of advisors believe that clients will rate their knowledge as moderate to low, compared to 45 percent of investors.

Investor Q: How would you rate your overall level of knowledge with respect to investing or the markets?

Advisor Q: How do you think your clients would rate their own overall level of knowledge with respect to investing or the markets?



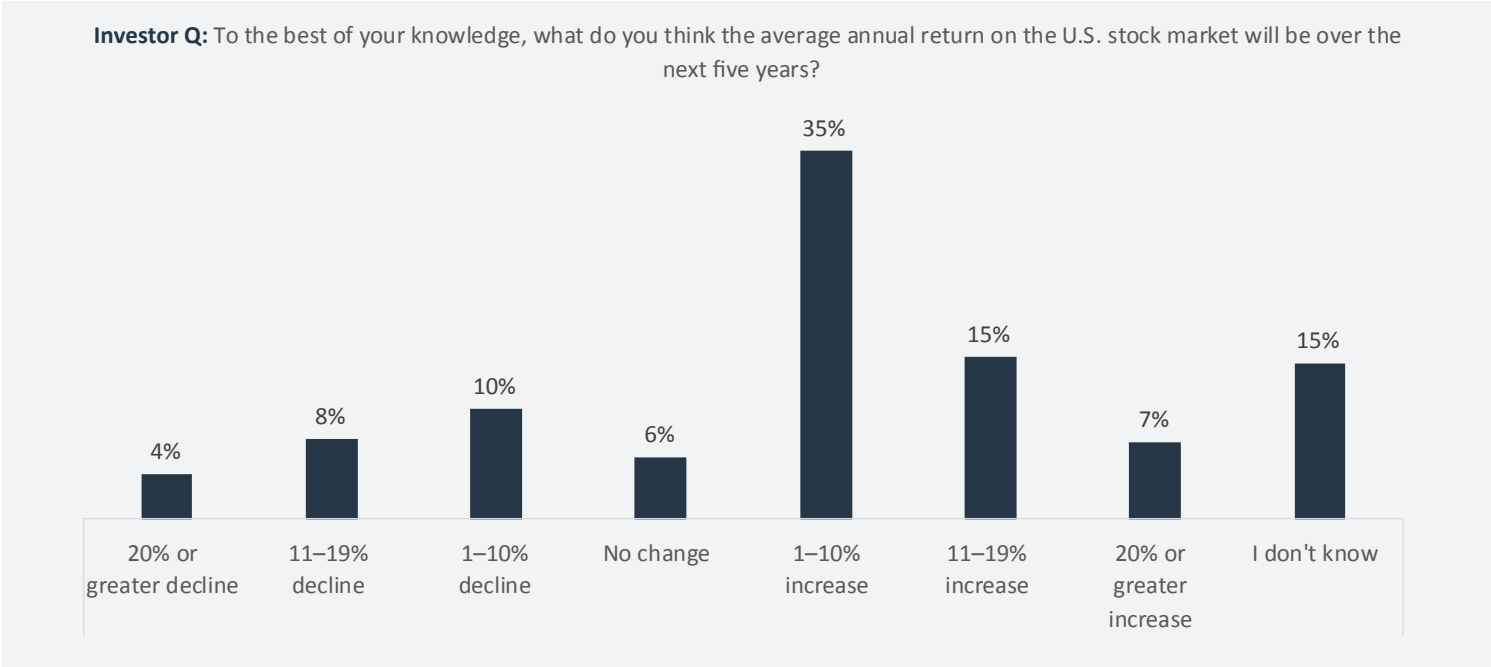
This disconnect is reinforced when advisors are asked if clients will be able to accurately identify maximum stock losses during defined periods of time. Advisors significantly overestimate the extent to which investors understand those losses.



Looking Forward: Expected Returns

Investment decision-making is, of course, not only tied to perceptions of the past but to beliefs in the future. Among investors, there is a general consensus that the market will go up. However, 22 percent believe there will be a decline.

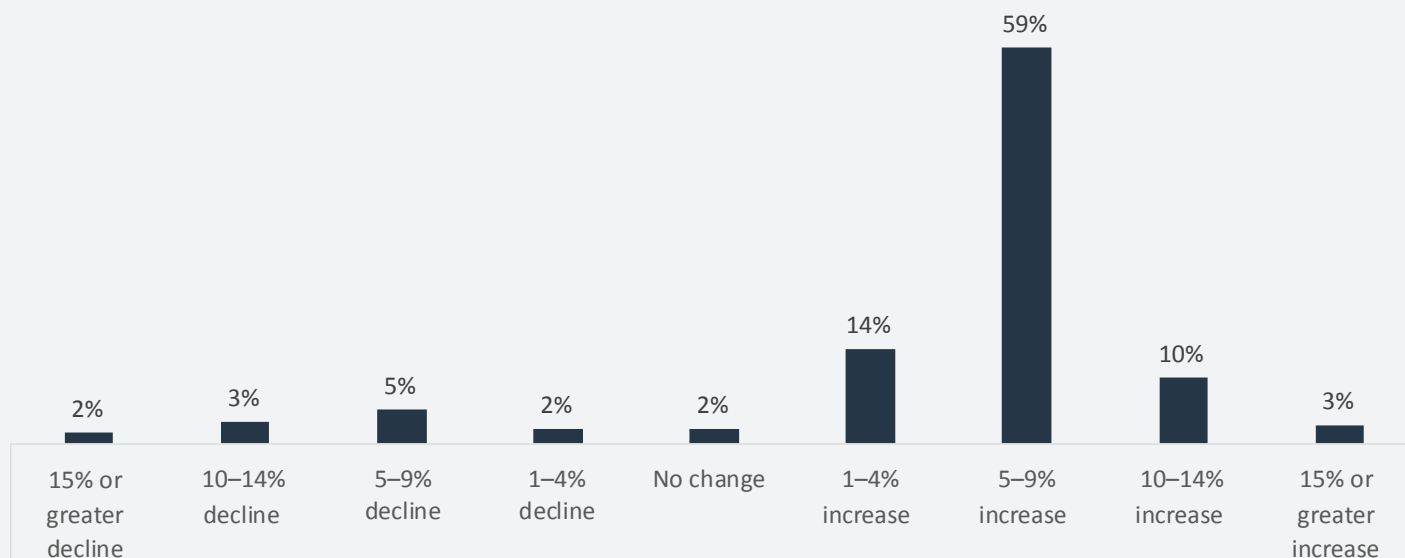
The trends among key segments continue when looking forward. Women and older clients are more likely to say they don't know what returns will be.



The Expectations Disconnect

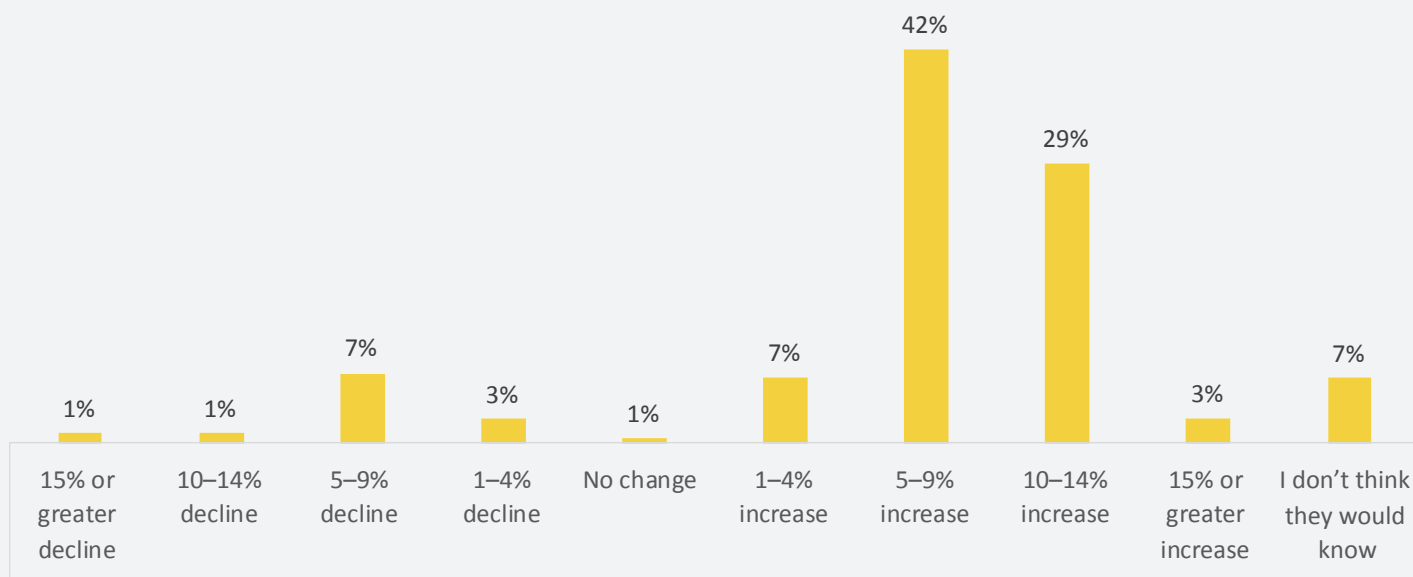
Advisors are more optimistic than investors; they also believe investors are more optimistic. A majority of advisors expect returns of 5 to 9 percent; however, 14 percent believe the stock market will be flat or decline.

Advisor Q: What do you think the average annual return on the U.S. stock market will be over the next five years?



Advisor optimism translates to their perception of investor expectations. Although about half of advisors think investors expect returns between 1 and 9 percent, only *35 percent of investors believe that will be the case.

Advisor Q: What average annual return do you think your clients expect on the U.S. stock market over the next five years?



Creating and Communicating a Plan of Action for Clients

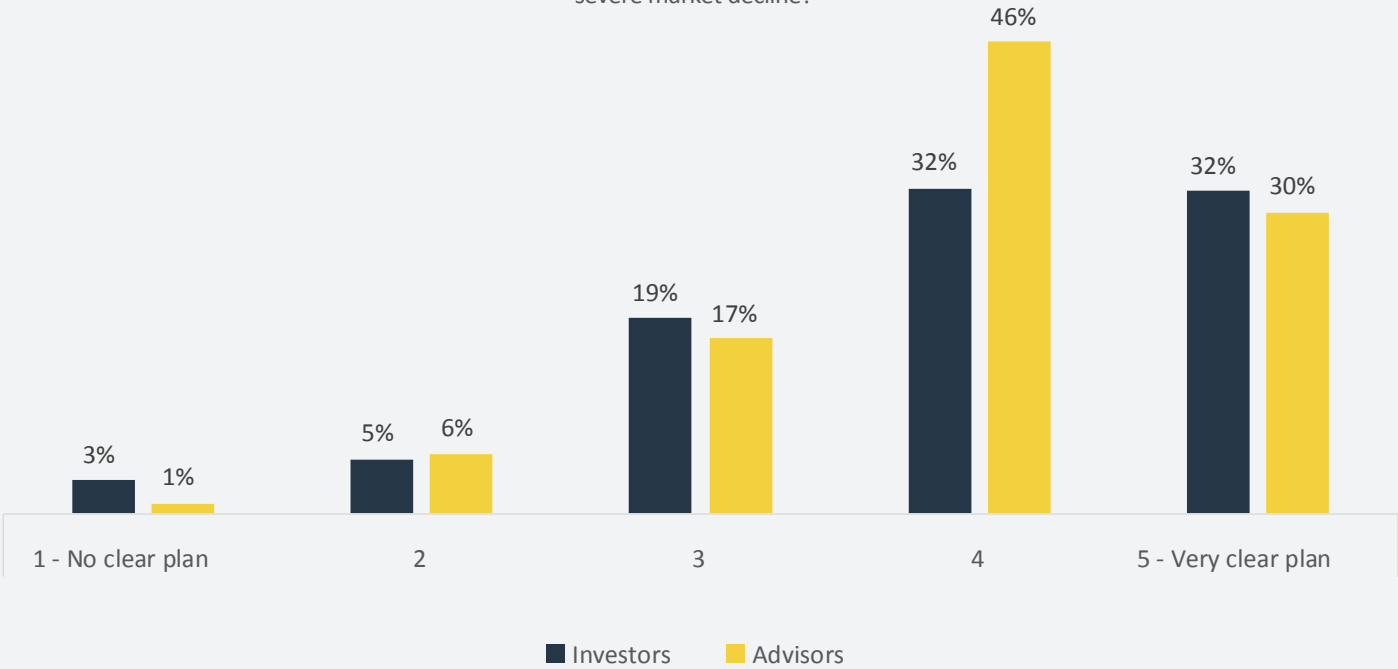
Irrespective of differences in knowledge, perceptions, or expectations, many advisors are planning for the unknown. That is, they are both designing and communicating plans in the event of significant market declines, stock market bubbles, or inflation. Despite those efforts, investors may not be aware of the plans that are in place.

*Data point not shown in graph

A high percentage of advisors say they are proactively planning for market declines. Seventy-six percent of advisors believe they have put together clear plans of action for their clients, should they experience a period of severe market declines or other market disruptions. Although the investors surveyed are not the clients of the advisors surveyed, there is a clear difference of opinion. Sixty-four percent of clients believe they have a clear plan of action in place.

Investor Q: To what extent do you feel that you have a clear plan of action for your portfolio, should we experience a period of severe market declines or other market disruptions?

Advisor Q: How would you describe the clarity of the plan of action you have put in place for your clients in the event of a severe market decline?



However, advisors are not optimistic that clients understand they have a clear plan in place. Only 11 percent of advisors felt their clients would describe the plan as “very clear.”

The question, then, is what advisors would recommend to their clients during periods of market decline? There is a general consensus that they would recommend that clients invest more in the stock market, particularly if the market falls 40 percent or more.

	Stop investing in the stock market completely	Stop investing in equities and shift to bonds or other more secure instruments	Invest more into the stock market	Other	No action; I would recommend they wait it out
If the market fell by 20–39% for a period of up to two years, what would you recommend to your clients?	0%	7%	55%	16%	22%
If the market fell by 40–49% for a period of up to two years, what would you recommend to your clients?	1%	9%	62%	16%	12%
If the market fell by 50% or greater for a period of up to two years, what would you recommend to your clients?	3%	8%	60%	16%	13%

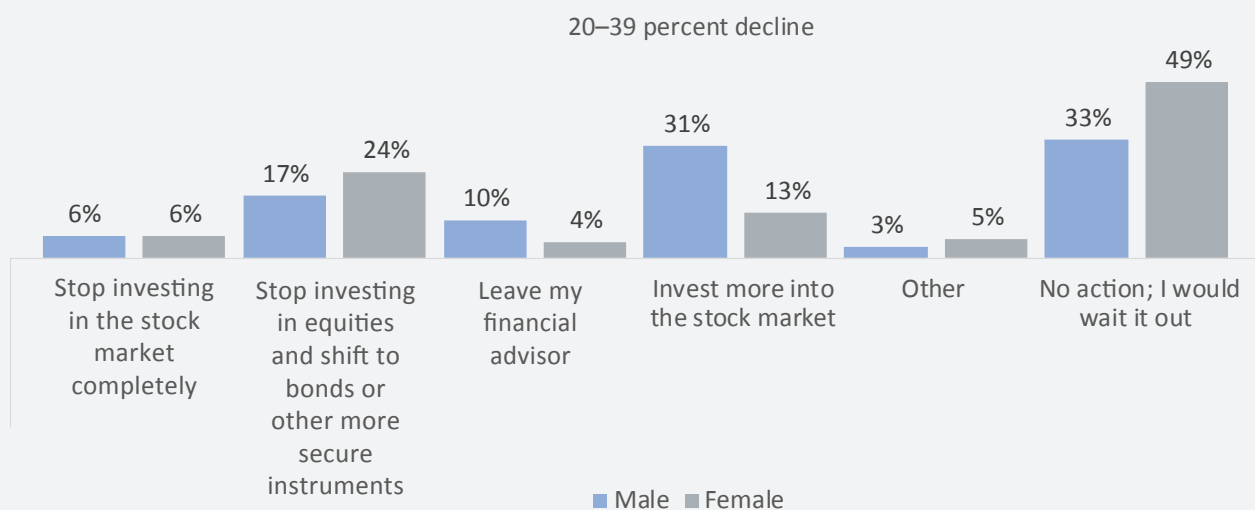
But what do investors say? The same question was asked of investors, with the addition of the potential that they might leave their advisor. The percentage who indicated they would change advisors was, thankfully low, but much higher in younger investors.

Investor Q: How do you think you would respond if the market fell by the amounts below for a period of up to two years?

Advisor Q: How do you think your clients would respond if the market fell by the amounts below for a period of up to two years?

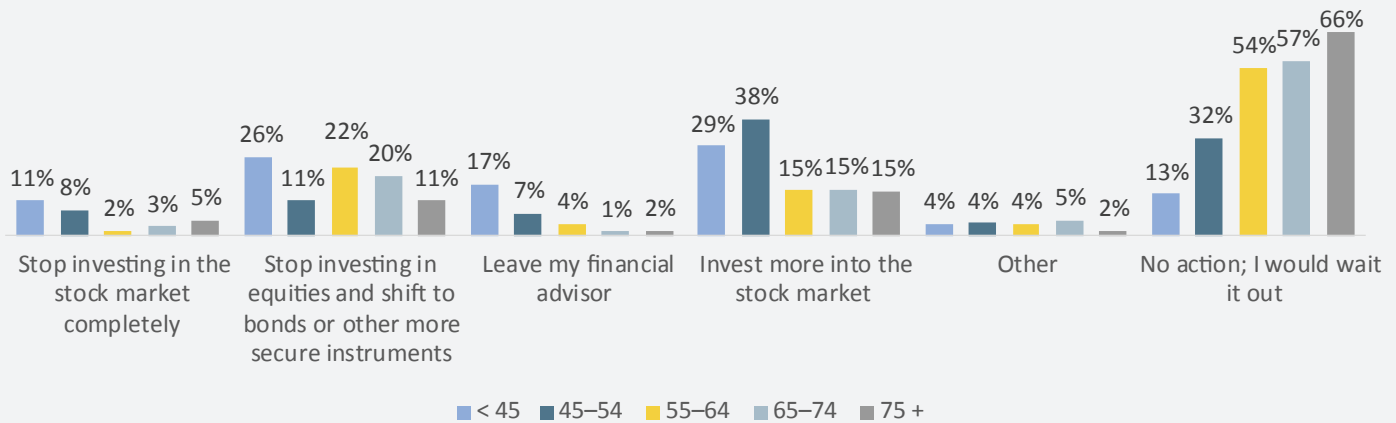
	Stop investing in the stock market completely	Stop investing in equities and shift to bonds or other more secure instruments	Invest more into the stock market	Leave my financial advisor/ consider changing advisors	Other	No action; I would recommend they wait it out
20–39 percent decline						
Investors	6%	20%	22%	7%	4%	40%
Advisors	10%	42%	13%	2%	7%	26%
40–49 percent decline						
Investors	10%	22%	20%	9%	3%	37%
Advisors	19%	39%	10%	4%	8%	20%
50 percent or greater decline						
Investors	12%	20%	22%	8%	4%	33%
Advisors	31%	24%	13%	9%	6%	16%

As we look at perceived responses, we continue to see differences based on client segments. As the chart below demonstrates, women are more likely to say they would wait things out and less likely to say they would invest more in the stock market.



Older clients were significantly more likely to indicate they would wait things out.

20–39 percent decline

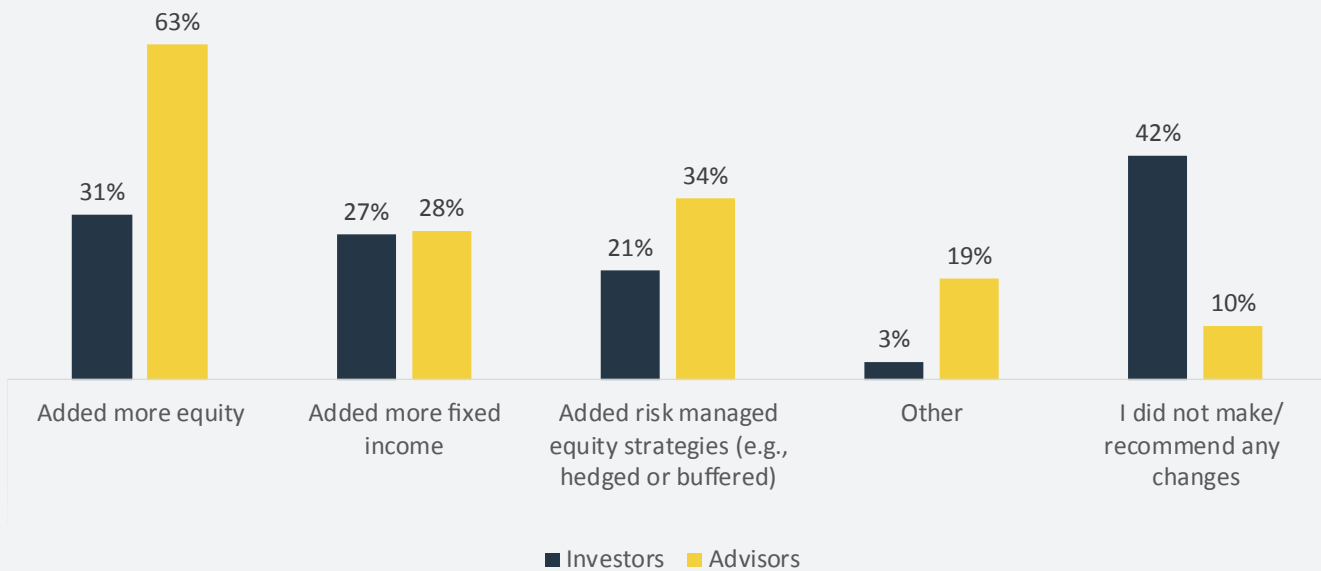


Responding to Current Market Conditions

In the past 12 months, a majority of advisors indicated they recommended an increase in equity positions in client portfolios, with roughly one-third recommending more fixed income or risk-managed equity strategies. However, investors were four times more likely to say they did not make any changes and fewer than one-third indicated they had added more equity.

Investor Q: Select all, if any, of the following actions have you taken in your portfolio in the past 12 months?

Advisor Q: Select all, if any, of the following actions have you recommended to clients in the past 12 months?

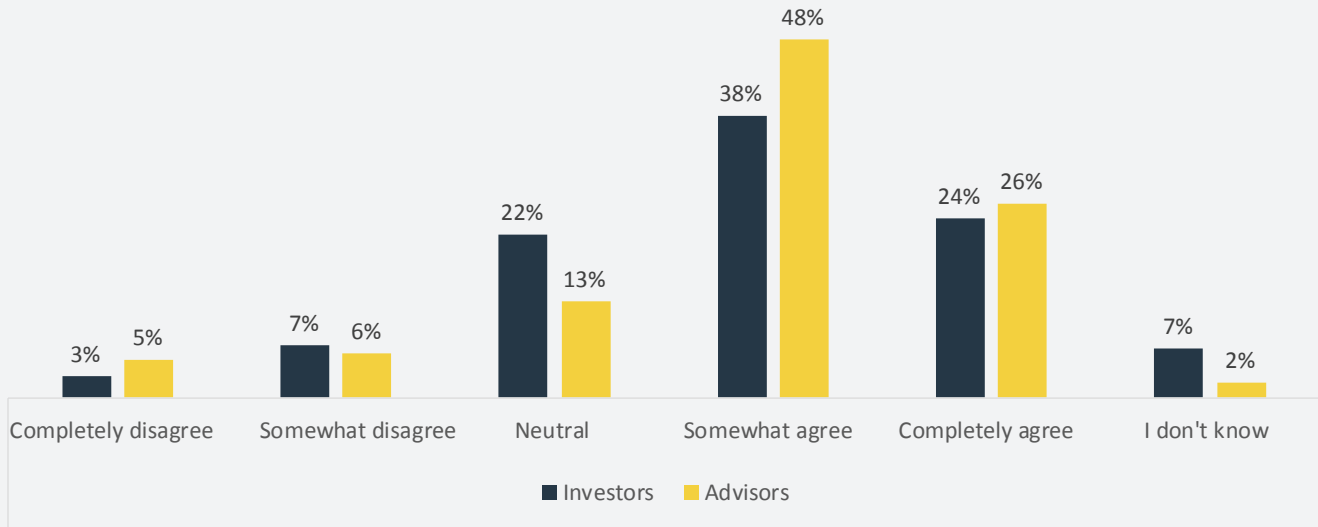


When asked if they would accept lower returns if they felt confident that the risk of losses would be reduced, investors and advisors are reasonably aligned. Fifty-nine percent of advisors believe that clients should accept lower returns to limit risk. However advisors think 74 percent of investors would agree that that was the best idea. Sixty-two percent of investors agreed.

Investor Q: To what extent do you would agree or disagree with the following statement?

Advisor Q: To what extent do you think your clients would agree or disagree with the following statement?

"I would accept lower returns if I was confident that the probability of experiencing significant losses due to negative market events would be lowered."

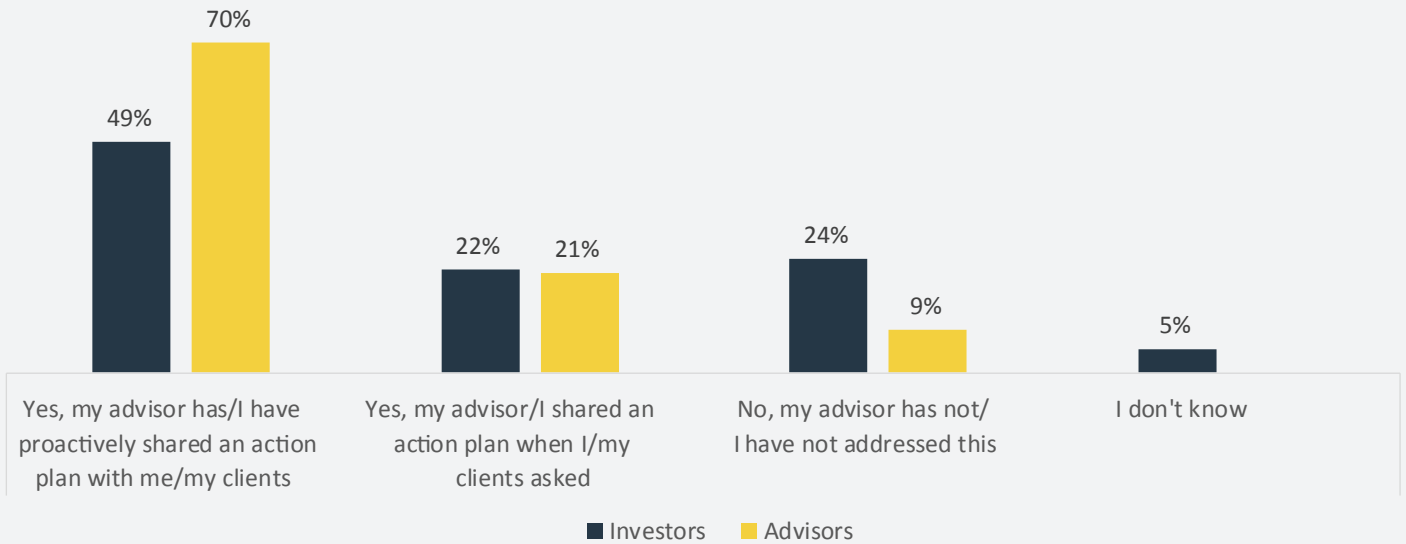


Communicating the Plan

Having a plan is one thing, however, communicating that plan is entirely different. Although a majority (70 percent) of advisors indicated they have proactively shared a plan with clients, only 49 percent of clients indicate that that is the case.

Investor Q: Has your advisor addressed what actions should be taken in your portfolio in the event of a significant or severe market decline?

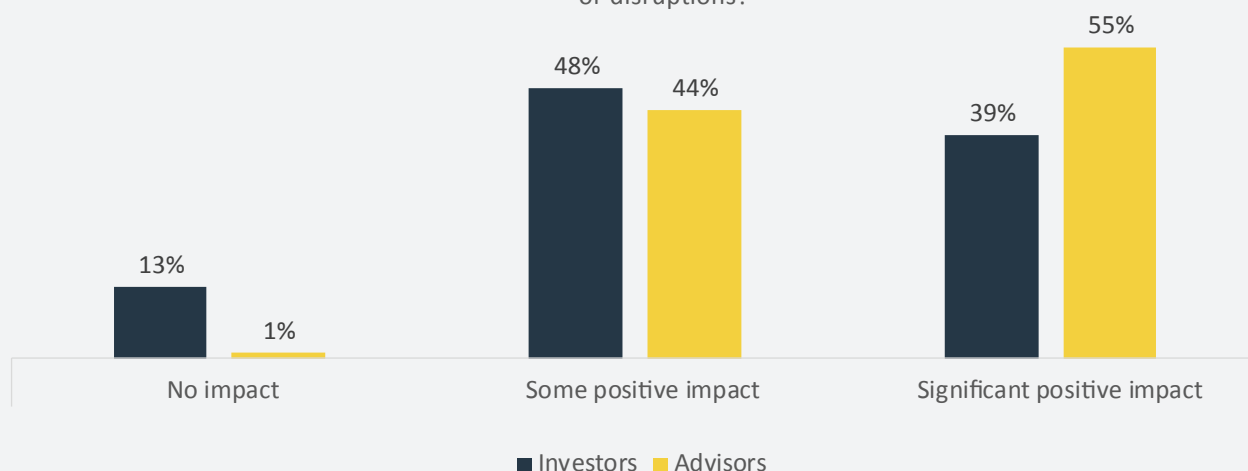
Advisor Q: Have you shared, with your clients, what actions should be taken in their portfolios in the event of a significant or severe market decline?



Investors see significant benefits to having a clear plan in place as it relates to their overall peace of mind. If they have a plan, they understand the benefits and see it as very positive. Eighty-seven percent of clients, who indicated they had a clear plan in place, said there was a positive benefit. Advisors also see a clear benefit.

Investor Q: What impact did this have on your peace of mind regarding your financial future?
(n=clients who responded “Yes” on having a clear plan of action)

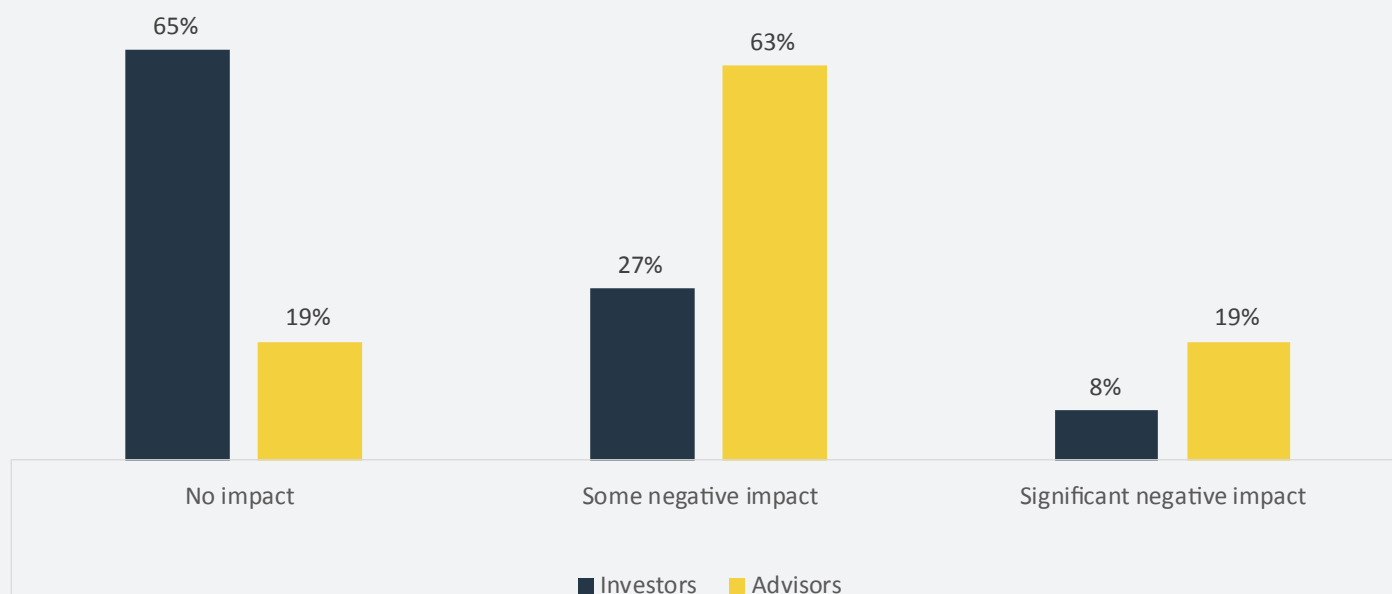
Advisor Q: How do you think your clients would describe the impact on their peace of mind of having a specific plan in place should we experience a period of severe market declines or disruptions?



It is interesting to note, however, that when investors don't have a clear plan in place, they do not necessarily see a negative impact. It is difficult to understand the implications of something you have not experienced. Advisors are considerably more likely to see the negative impact.

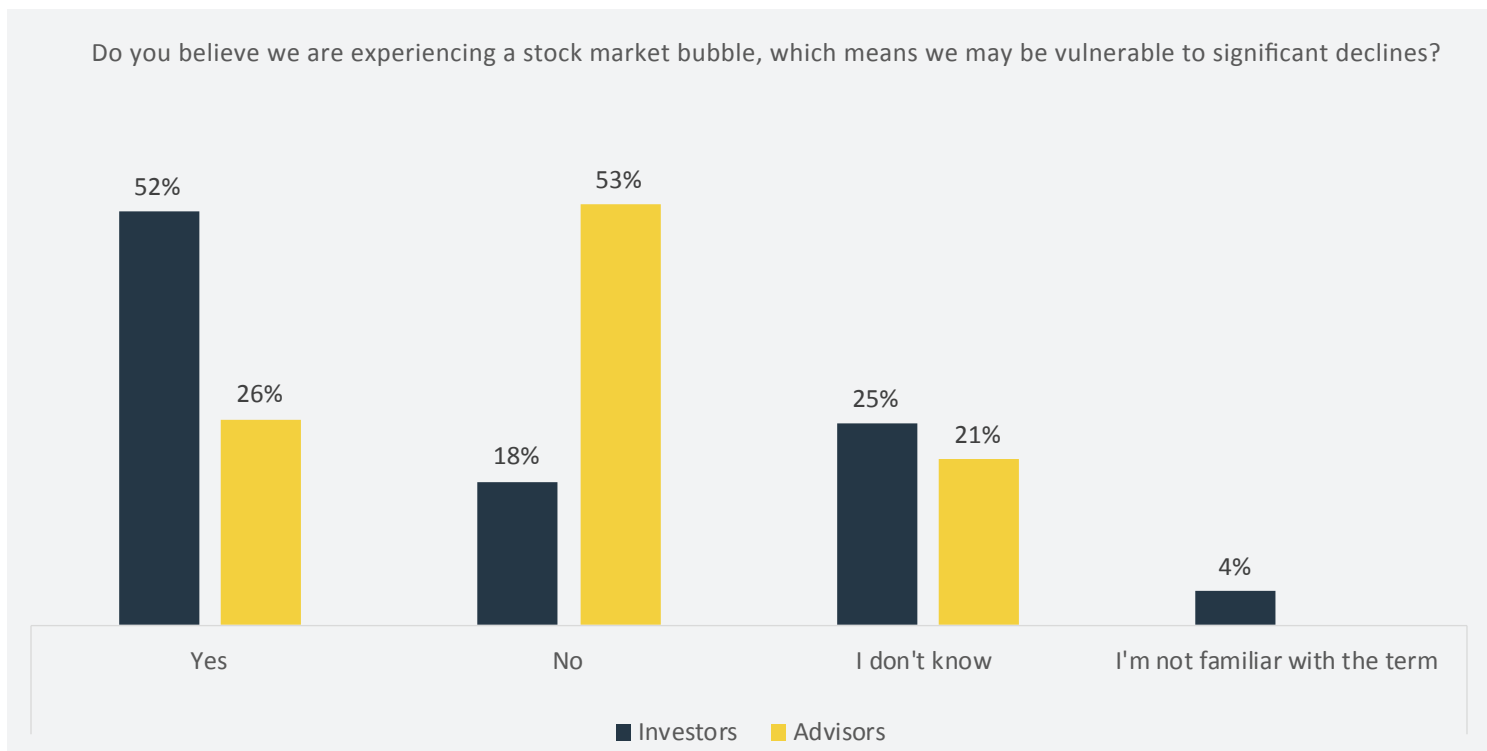
Investor Q: What impact did this have on your peace of mind regarding your financial future?
(n=clients who responded “No” on having a clear plan of action)

Advisor Q: How do you think your clients would describe the impact on their peace of mind of not having a specific plan in place should we experience a period of severe market declines or disruptions?

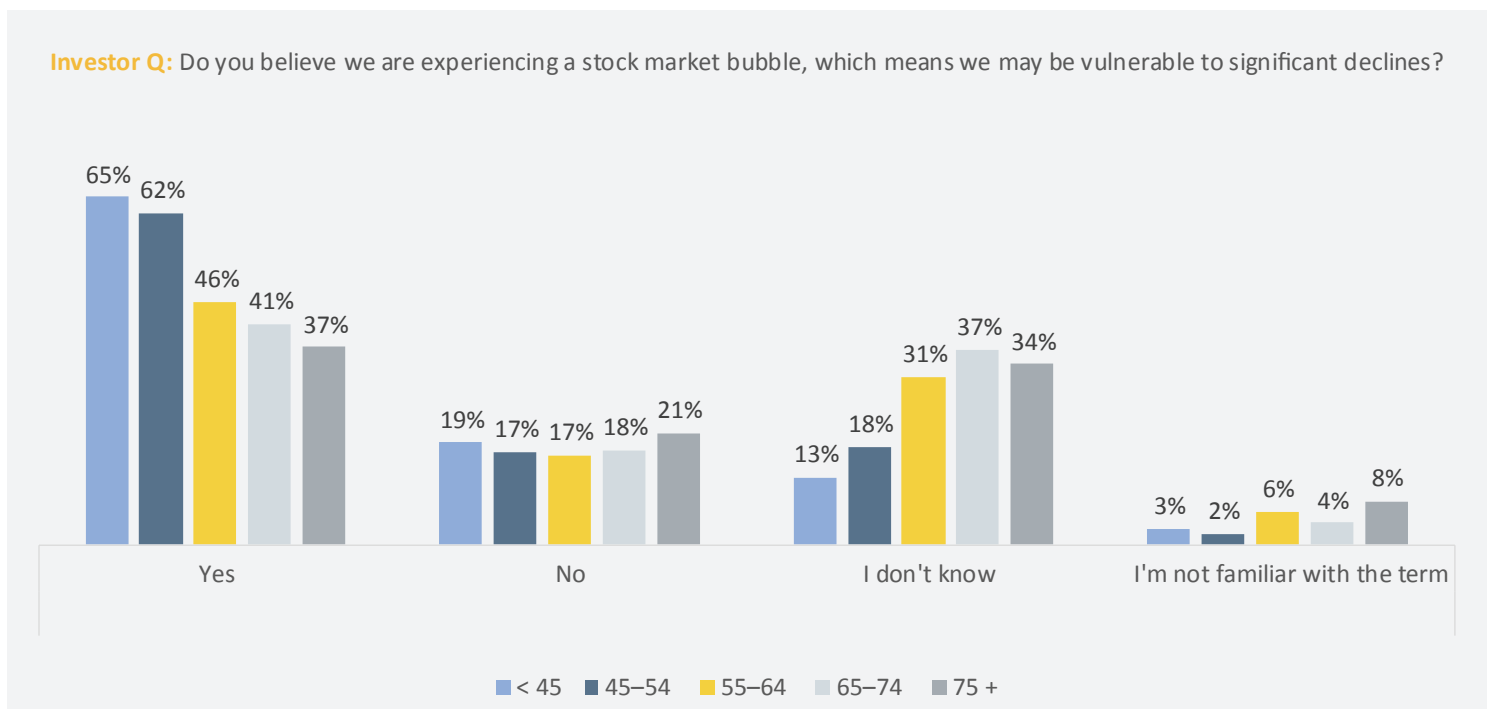


Planning for a Stock Market Bubble

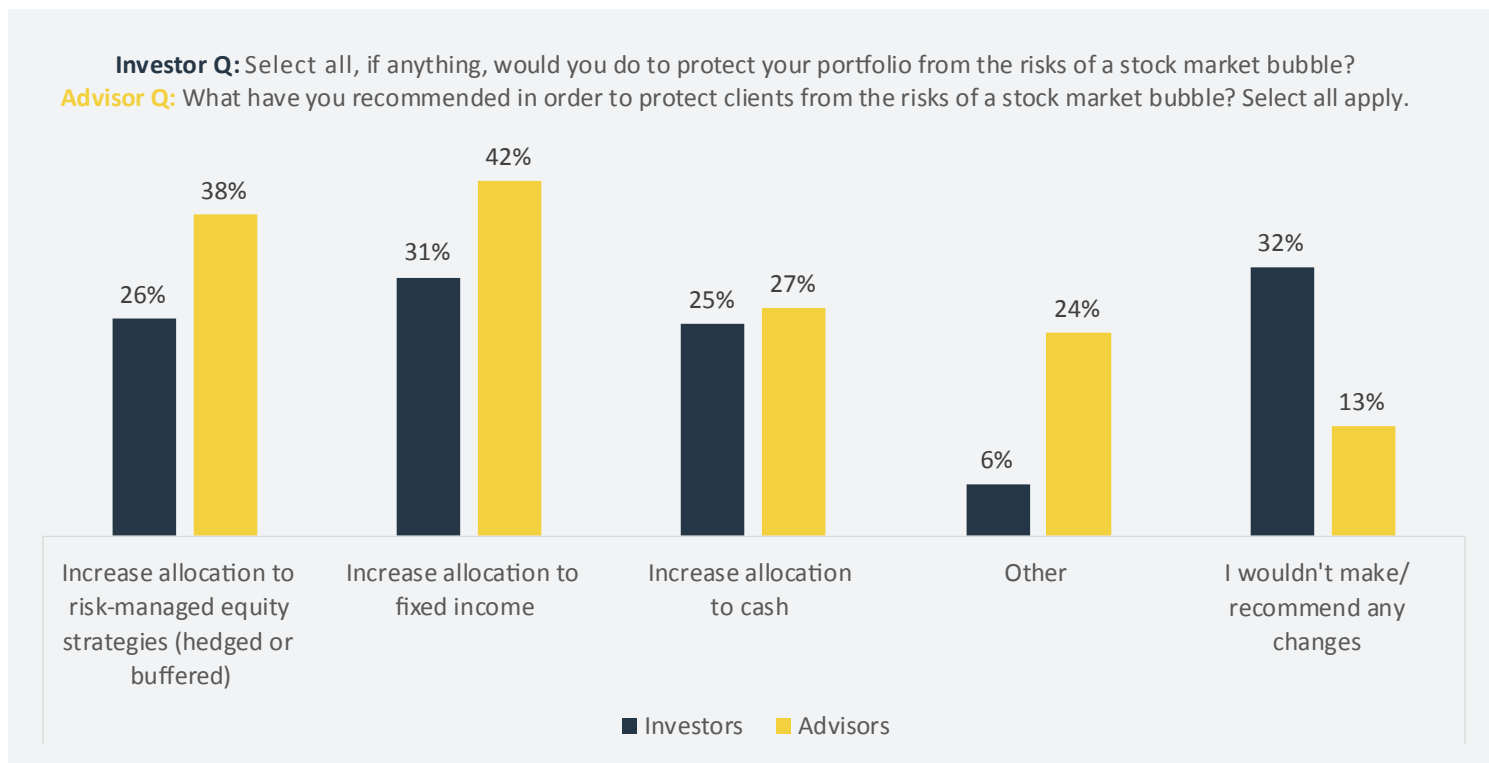
One area in which investors and advisors are very far apart is how they define current market conditions (as of May 2021). About twice as many investors as advisors believe that we are experiencing a stock market bubble.



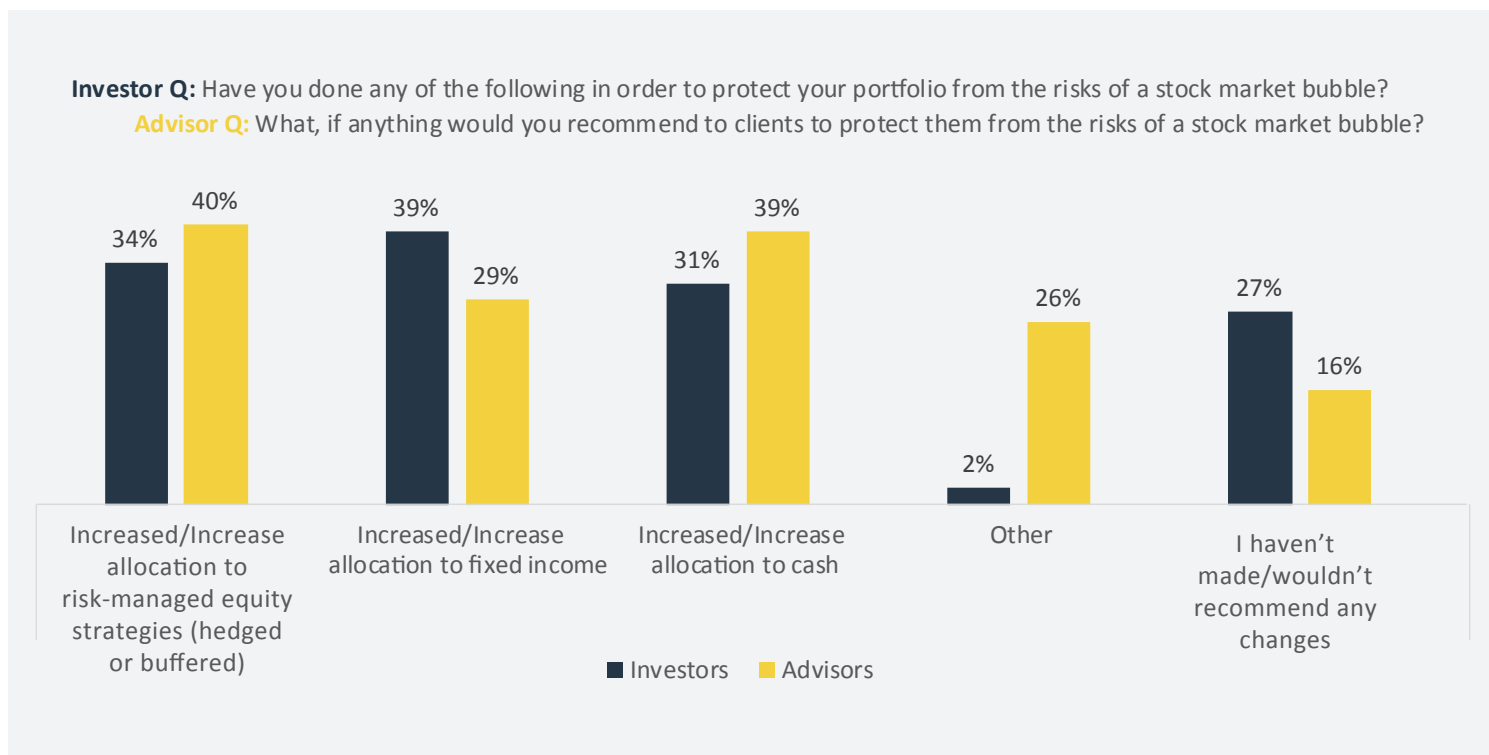
Younger clients, who identify as more knowledgeable, are more likely to say we are experiencing a bubble.



Perhaps as a result of the disconnect, there is also a disconnect on the best response to a bubble. Among those advisors and investors who do not believe we are experiencing a stock market bubble, there is a disconnect on what to do should that change. Advisors are considerably more likely to suggest an increased allocation to risk-managed equity strategies and fixed income. Investors are considerably more likely to want to stand firm and do nothing.



However, among investors and advisors who believe we are experiencing a stock market bubble, there is more alignment on the appropriate response.

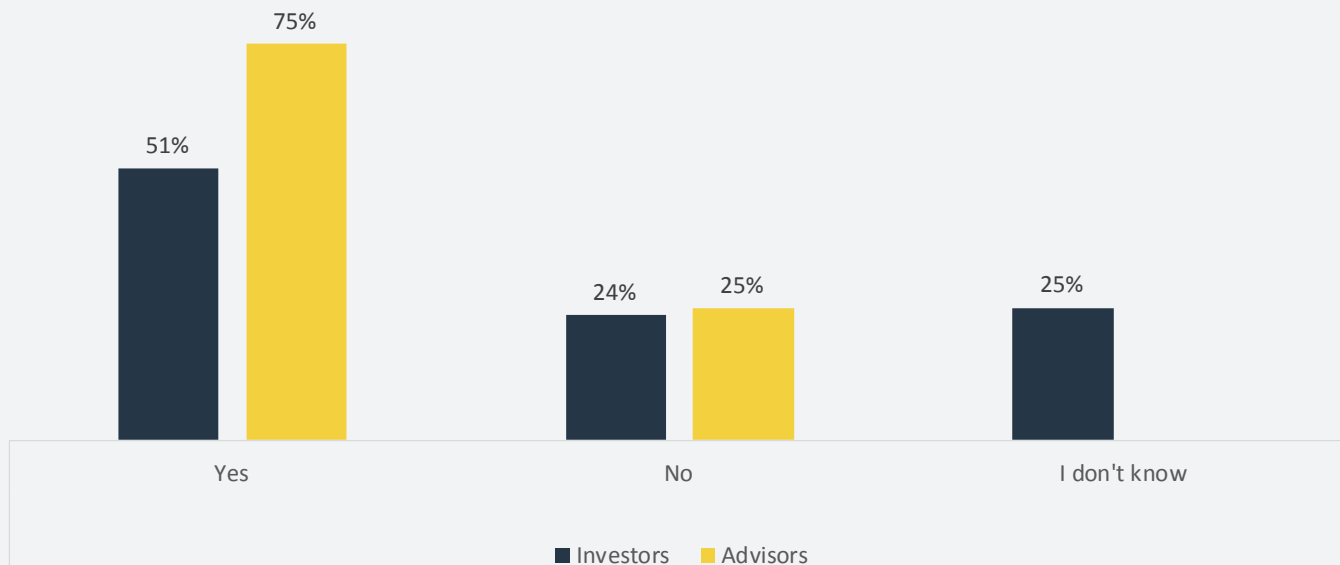


Planning for Inflation

When it comes to planning to defend against significant increases in inflation, advisors and investors have different views on the clarity of the plan. Three-quarters of advisors indicated that they had taken steps to defend against inflation, dropping to 51 percent for investors.

Investor Q: Has your advisor taken steps to defend against significant increases in inflation, should they occur?

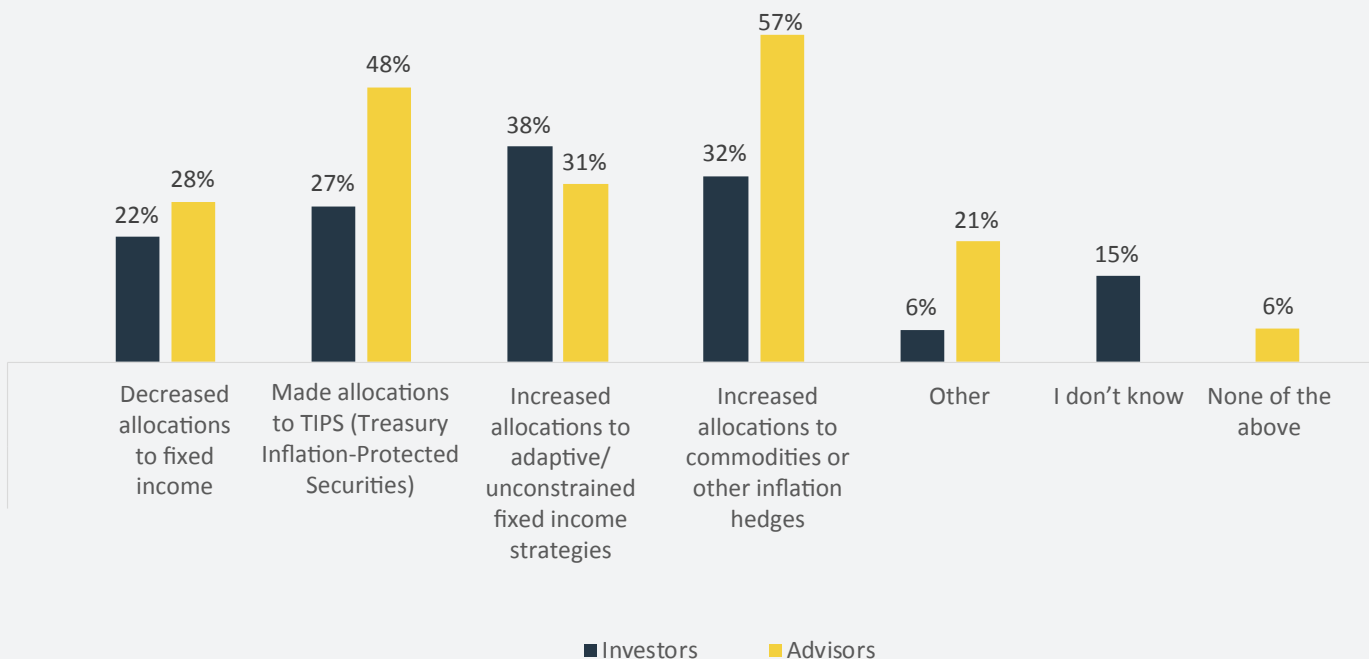
Advisor Q: Have you recommended steps to defend against significant increases in inflation, should they occur?



It is not surprising that investors have a different understanding of what has been done to protect against inflation. Among advisors, the two dominant strategies allocate more to Treasury Inflation-Protected Securities (TIPS) and increase allocations to commodities or other inflation hedges.

Investor Q: What steps has your advisor taken to defend against significant increases in inflation? Select all that apply.

Advisor Q: What steps have you recommended to defend against significant increases in inflation? Please select all that apply.



Conclusion

There is little debate that investors fall victim to emotional responses that may run contrary to their long-term goals. The data gathered highlights this point and demonstrates that many investors are, in fact, quite self-aware. It is also clear that decision-making is strongly influenced by our understanding of the past, our expectations of the future, and our own confidence in investment knowledge.

And although advisors understand that investors can fall victim to these behavioral challenges, the data highlights something very important. This study makes two things very clear.

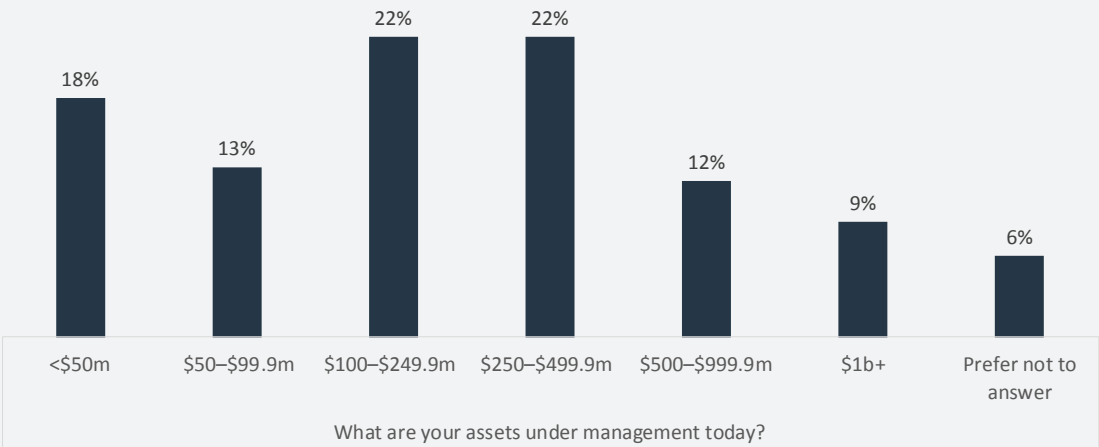
1. Investors have an imperfect understanding of history and a relatively low level of investment knowledge. These gaps may impact their decision-making.
2. Advisors are making incorrect assumptions about clients' understanding of history, their perceived investment knowledge, their views of the future, and their understanding of the plans that are in place. This gap means advisors may be missing opportunities to support clients in a meaningful way.

We have an opportunity to close these gaps through deeper conversations with clients, by checking our own perceptions, by ensuring that there is a clear and proactive plan in place to respond to market uncertainty, and by communicating those plans—and communicating them again.

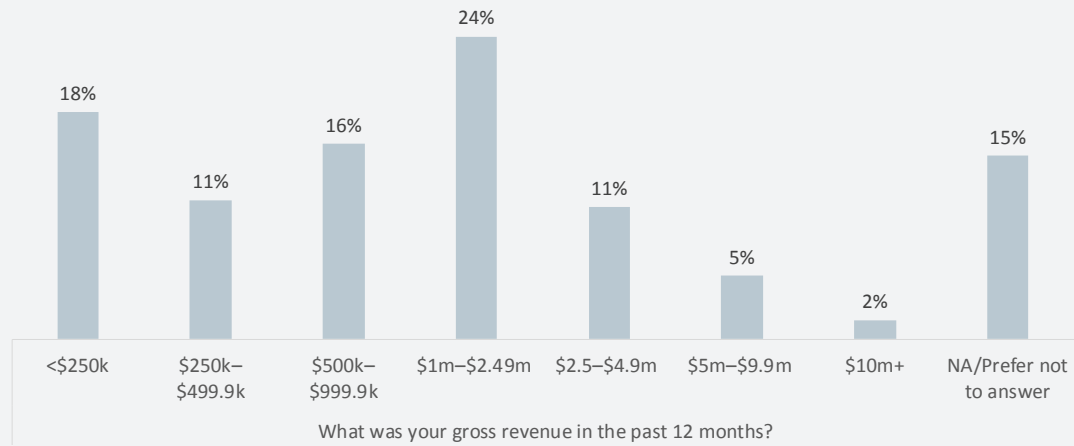
Appendix

Advisor Profile

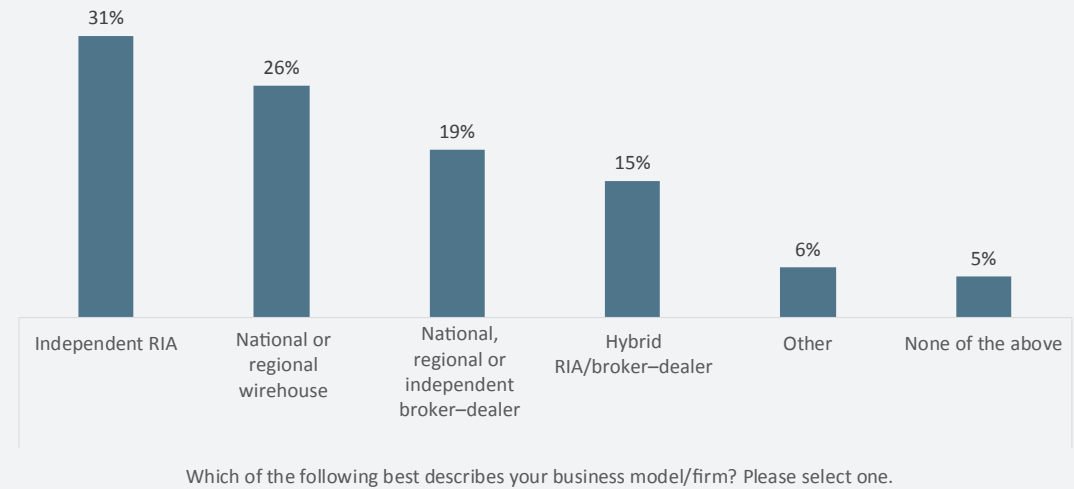
Assets Under Management



Gross Revenue

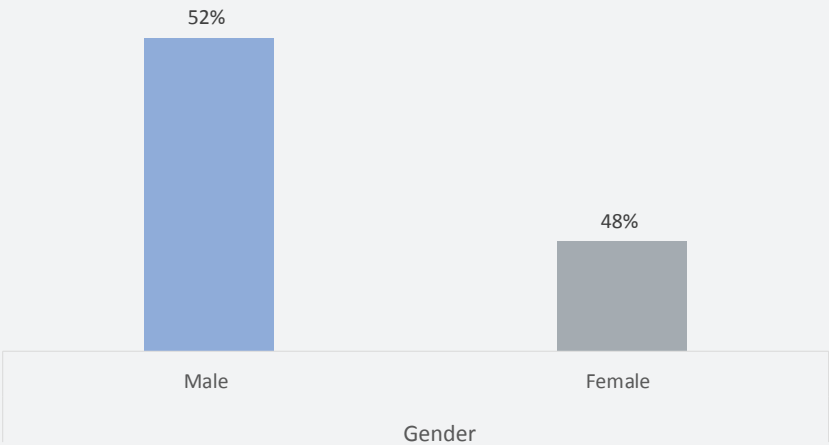


Channel

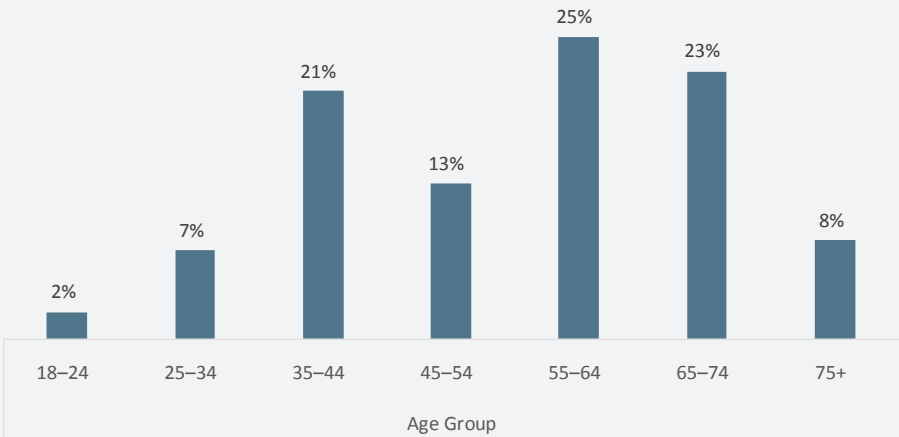


Investor Profile

Gender



Age



Household Investable Assets





About The Behavioral Investing Institute

Toews' Behavioral Investing Institute, a division of Toews Corporation, provides behavioral finance training for advisors through workshops, seminars, and coaching. The Behavioral Investing Institute's workshops and seminars provide implementation ideas that will enable the audience to improve on their ability to recondition their clients' perception and emotional response to various market cycles. Our one-year coaching program guides advisors through a training framework that seeks to change investors' default emotional responses to various market challenges. Each student in the coaching program will have ongoing access to their personalized behavioral guidance tools and analysis, as well as stay current on the ongoing evolution of our tools as they develop. Upon completion of the Behavioral Finance Coaching Program, financial advisors become part of a community of investment professionals committed to ongoing learning in the field of behavioral finance. For more information, visit www.biicoaching.com.



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About Absolute Engagement

Absolute Engagement is an organization that prides itself on being an expert in elevating the client experience and helping advisors drive practice growth. Founder and Chief Executive Officer Julie Littlechild is a recognized expert on the drivers of client engagement and a popular speaker on how client experience is being disrupted and how to leverage those trends to drive referrals. Ms. Littlechild has presented at numerous Institute events, both in-person and online. She has worked with and studied successful financial advisors and their clients for more than 25 years. Previously, Ms. Littlechild launched and ran one of the industry's leading research firms, focused on client engagement. She is the author of a popular blog, the co-host of the *Becoming Referable* podcast, and the author of *The Pursuit of Absolute Engagement*. For more information, visit www.absoluteengagement.com.



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