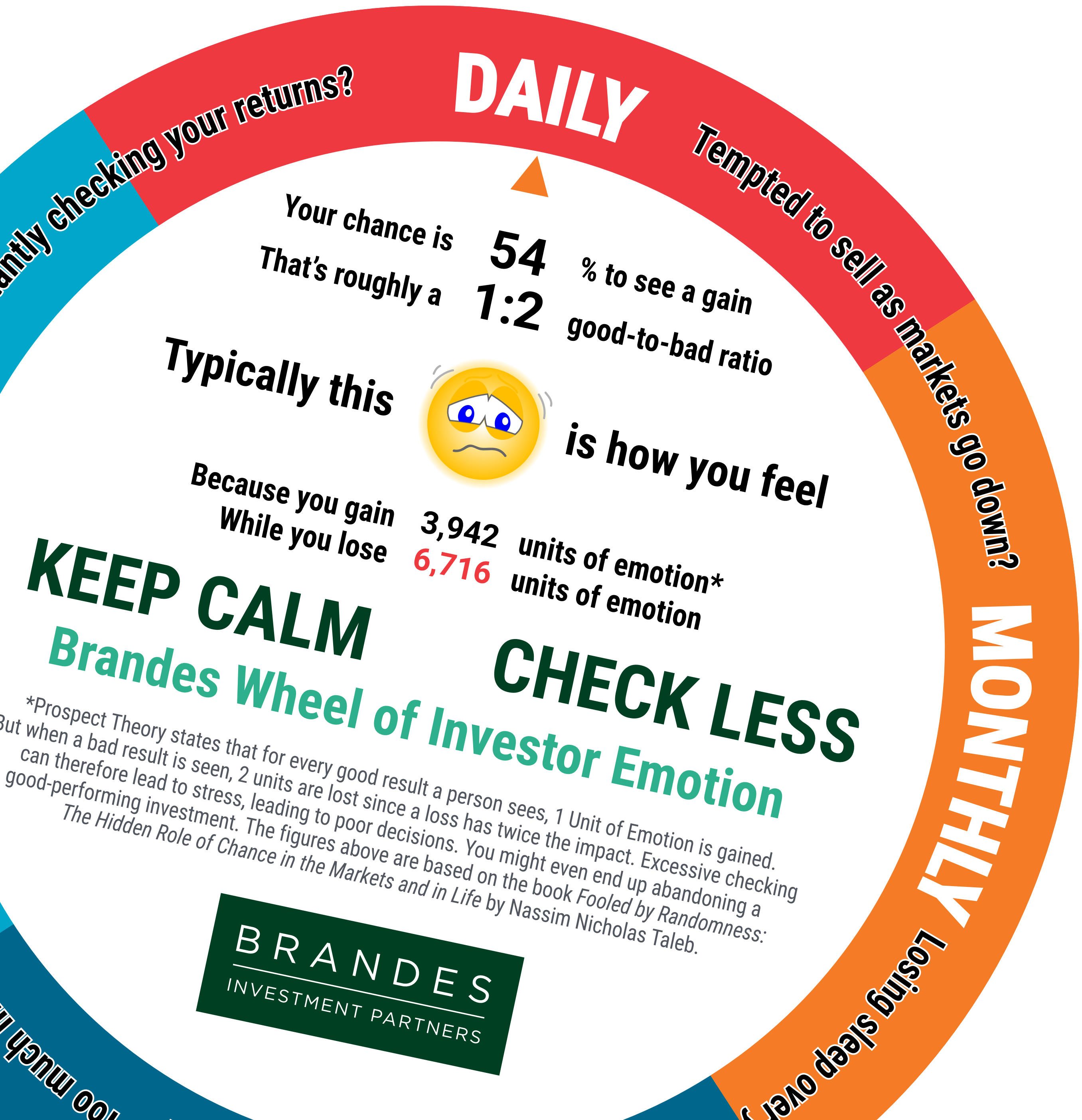
BRANDES
INVESTMENT PARTNERS

### Keep Your Clients Invested for the Long Term:

# Wheel of Investor Emotion Guide

ADVISOR REFERENCE MATERIAL



For quick-start instructions, see the Wheel of Investor Emotion Instruction Sheet.

# The Wheel of Investor Emotion

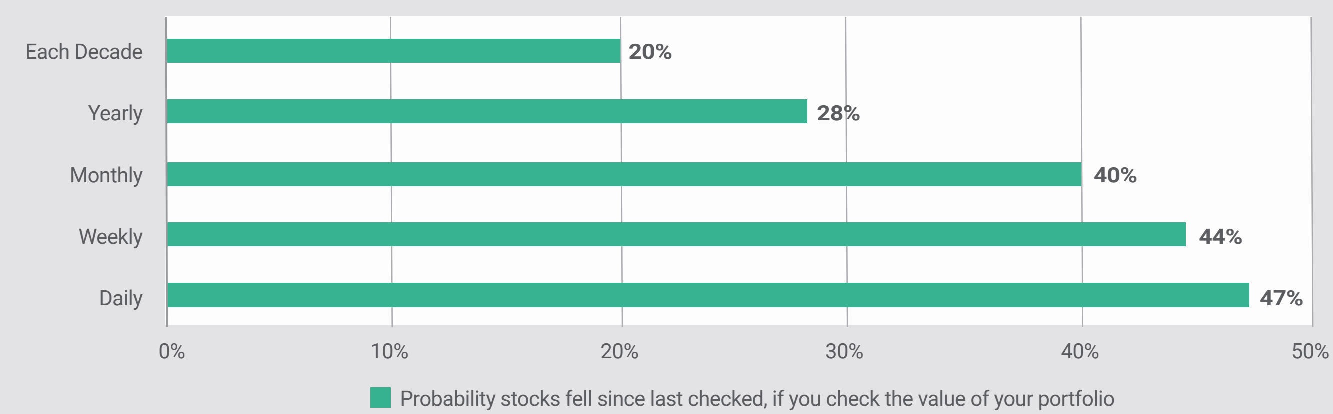
## Benefits of This Easy-to-Use Tool

Dealing with client emotions is part of every financial advisor's practice, and it's no easy task. Brandes' Wheel of Investor Emotion ("Wheel") can help by starting a dialog with clients about their emotional response to losses.

The Wheel illustrates the potentially harmful physiological effect of checking investments too frequently. Why? The sting of a loss tends to linger on investors' minds, regardless of whether it is short term in nature or a result of daily market fluctuations. As financial markets are often volatile, whether an investment goes up or down in any given day is essentially a toss-up. When it comes to investor emotions, a loss hurts more than a gain feels good and investors may be best served by checking less frequently.[1] Importantly, keep in mind that over long periods, investments in stocks and bonds have historically produced gains.

Additionally, long-term investors may be spared from stressing over portfolio returns by considering that the stock market is less likely to fall over long periods, as shown in the chart below.

The Stock Market Is Less Likely to Fall Over Longer Periods[2]
If you check your portfolio less often, you'll be less likely to discover a loss.




Source: S&P 500 closing prices from March 4, 1957, to present.
Published Aug. 24, 2015.

## Background Theory

In his book *Fooled by Randomness: The Hidden Role of Chance in the Markets and in Life*, Nassim Taleb demonstrates that the more frequently investors check their investments, the lower the probability they have of seeing a gain and, consequently, the more emotionally drained they wind up being.

According to the "Prospect Theory" developed by Nobel Prize winner and psychologist Daniel Kahneman, negative events have *twice* the emotional impact as positive ones. Imagine the client accumulates one positive emotional unit for every gain they see, and *two* negative units for every loss they see.

[1] Richard Thaler, *Misbehaving: The Makings of Behavioral Economics*
[2] "How Emotions Hurt Stock Returns," Justin Wolfers, New York Times Aug. 24, 2015—http://www.nytimes.com/2015/08/25/upshot/how-emotion-hurts-stock-returns.html?_r=0

*"So we experience life in terms of changes, we feel diminishing sensitivity to both gains and losses, and losses sting more than equivalently-sized gains feel good."*

– Richard Thaler, author, *Misbehaving: Thae Making of Behavioral Economics*

## Ways to Use the Wheel

We suggest walking your client through the various scenarios. For example, set the Wheel to "Monthly" and you'll see 161 positive and 158 negative emotional units. The good-to-bad ratio is about 1:1.

Next, assume the portfolio begins to under-perform and the economy enters a downturn. The client is now more concerned and checking daily. Since the probability of seeing gains is only 54%, the client sees more losses (accumulating 3,942 positive and 6,716 negative emotional units—a ratio of 1:2). The client may experience stress, whether they realize it or not.


## Stress is Bad for You

In *Inside the Investor's Brain*, psychiatrist Dr. Richard Peterson points out that chronic stress can lead to physical ailments such as interrupted sleep, high blood pressure, accelerated aging and decreased immune functions.

Some clients react to the stress of seeing declines by bailing out—potentially the worst thing they can do. This is especially true for clients who are close to retirement or have already retired.

### Your goal is to prevent this from happening.

Turn your clients' attention to the "Quarterly" section of the Wheel. With a 77% probability of seeing gains, the client will likely accumulate 62 positive and 36 negative emotional units.

By simply checking the performance of their portfolio less frequently, the gains vs. losses ratio is now 2:1. Compare that to checking the investments just once every year. With a 93% chance of seeing gains, the client accumulates 19 positive and only 2 negative emotional units.

The client experiences less stress and is more likely to stay invested, and achieve their long-term goals.

## Visualize

At this point, you might ask clients to imagine how they would feel to be this happy individual.

Ask them to work on checking less frequently. You may suggest taking it in steps—from checking daily to monthly, to quarterly, then ultimately yearly.

## Action Plan

The Wheel of Investor Emotion promotes patience and may help clients effectively manage the emotional volatility associated with investing. The Wheel is designed to help you modify client behavior over a period of time. It is most effective when used in conjunction with a well thought-out, comprehensive investment action plan.

Keep in mind that client behavior does not change overnight, so success will come in increments. If you can slowly get clients used to not looking at short-term results, you are doing well.

# Wheel of Investor Emotion: A Hypothetical Example

ADVISOR PROFILE: At the age of 50, Mike Smith is an advisor with 20 years of investment experience. He manages wealth for 100 client families (70% are baby-boomers). Mike is a CFA charterholder and an advocate of the Graham-and-Dodd value investing approach.

SITUATION: Following the latest global financial crisis, many of Mike's clients were nervous and fearful about a negative impact on their investments. With no sign of a quick stock market rebound, some clients called Mike, in a panic, everyday. Mike tried using every chart and analysis possible to convince clients to stay the course but a small group was still stressed out and upset.

ACTION TAKEN: After meeting with his Brandes Regional Director and being asked to test run the Wheel of Investor Emotion, Mike decided to give it a try. He invited 20 of his most nervous clients (and their spouses) to an informal session. He presented:

- a review of an underperforming portfolio his clients own
- the concepts outlined in the first part of this document

DURING THE SEMINAR: Mike refers to the Wheel of Investor Emotion and the various frequency slots at which clients check their investments—monthly, daily, etc. He shows that the more frequently clients check, the more likely they see losses. He also shows the different emotional states associated with the various frequencies.

When talking about the physiological effects associated with seeing losses, Mike noticed a lot of "SEE I TOLD YOU," exchanges between several cou ples in attendance! Bob and Susan are particularly animated. Mike received many calls from Bob following the latest global financial crisis, and Bob had been increasingly upset each time.

Mike knows some spouses may not even know how badly their investments declined, but they witnessed the ailments their husband or wife experienced, such as interrupted sleep, irritability, higher blood pressure and muscle tenseness. Mike sadly pointed out that checking returns too frequently can not only affect an investors long-term returns, but their health, too.

Mike then turned the Wheel to the "Quarterly" and "Yearly" slots. By checking less, he shows how a client has a higher probability of seeing gains, thus reducing stress. In the case where a client only checks his investments once a year, this client is much happier and far less stressed out over the long term.

RESULTS: Mike planned to call Bob and Susan right after the seminar; however, they approached him first and apologized for calling in a panic, repeatedly. They pledged to start by checking their investments just once a quarter. Mike, Bob and Susan agreed to schedule meetings to review what plans they have and to prepare for future ups and downs in the market.

Mike now plans to use the Wheel of Investor Emotion with more of his nervous clients to help them stay invested and focused on their long-term financial goals.