Manulife

Text On Screen: Manulife. Understanding Investor Behaviour.

What drives investor behaviour?

David R. Lewis. PhD, MBA, CFA. Chief Client Officer, BE works.

David sits in a brightly lit office. He faces away from a large window. He wears a suit and tie and has glasses.

David: So, investors make irrational decisions during volatile markets because of the fundamental nature of their neurophysiology. We have two modes of decision making, system one and system two. System one is relatively effortless and intuitive. System two is effortful and highly rational and considers information rather than emotion.

David's interlocked fingers rest on a black portfolio.

David: We tend to become more biased toward system one during periods of market volatility due to panic. The result of that is that we become subject to loss aversion. We become much more concerned about losses than gains. We tend to shorten our time frame, think about recent events and assume that those recent events will continue on into the future. That's called projection bias. We also tend to be overconfident in our ability to make decisions, because we become more fearful that others are less capable of making those decisions. As a result, we tend to make normatively suboptimal decisions during periods of market panic.

Text on screen: what are the consequences?

David's elbows rest gently on a desk. His arms in a 'V' shape with one hand covering the other.

David: The consequences for investors and their advisors are suboptimal performance, first of all. Investors, if they pull money out of the markets during periods of volatility invariably leave the money out too long and miss out on the recovery, and as a result experience suboptimal performance. There's another bias that's at work, and that's self-serving bias. People tend to believe that they made the right decision and any negative outcome of that correct decision was due to the influence of a third party or another party. So even though the investor may have decided to pull his money out of the market, or her money out of the market, they tend to attribute that blame to the financial advisor, even though it was their own decision. And as a result of that, their suboptimal performance, blaming the advisor, and in the long run, a degradation of the relationship with the investor and the advisor.

Text on screen: How does Behavioural Economics help advisors?

David: Incorporating behavioural economics helps advisors to understand the reasons why consumers are making decisions, and if you can understand why people are making certain decisions, you can then consider tactics to help them overcome those suboptimal decisions.

Text on screen: Any last comments?

David: So, I think a last comment I'd make to advisors is that advice is going to be the differentiator in the future. Product is not a sustainable differentiator. It can too easily be duplicated. Advisors who move towards advice are going to much more powerfully embed their clients in their business and have clients who are more satisfied and consolidate business with them instead of away.

The Manulife logo pushes onto the centre of the screen and changes from white to green. It's three vertical lines stand parallel, in the shape of the letter 'M'. A glare briefly appears behind the logo.

Text on screen: Manulife.

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