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5 key takeouts: Conference 2014 Finology Forum

Angela Ashton | PortfolioConstruction Forum | 27 August 2014

Last Tuesday, as the first day of our annual PortfolioConstruction Forum Conference program, we hosted our first annual Finology Forum. Finology is the emerging (and converging) research field covering the study of minds, customs and behaviours with respect to money. Our particular focus of finology is as it applies to the giving of investment advice. It incorporates behavioural finance, and much, much more. Essentially, Finology Forum was about where investing meets investors.

Like many fields of research, finology has its genesis in the US. Fittingly, Michael Kitces, partner and research director with Washington DC-based, high net worth financial planning firm, Pinnacle Advisory, started proceedings with an overview of finology. He was recently recognised by *Investment News* magazine as one of the top "40 under [age] 40" leaders in the US investment world. As he explained, our capacity to understand a client's state of mind will drive our ability to communicate well. Without this understanding, good advice can go untaken – to the client's detriment. Michael also discussed the various relationships people have with money. Some see it just as a tool for fun, some see it as security for their family, and so on. Not understanding a clients' relationship with money can lead to the adviser's messages being framed in a way that does not connect.

David Lazenby, a St Louis-based psychologist and CFP who specialises in working with high net worth families and also works with the Federal Reserve, told delegates that goals-based planning misses a key point. Emphasising goals with clients can be problematic, he explained, because if the goal is not reached, trust is breached. Advisers should instead start the planning process by helping clients practice scenarios around their ultimate goals. If they don't then meet their goals, the client knows how to react.

In his later session, David discussed methods for building trust with clients. One of his key points was that, in building trust, the quality of our responses is much more important than the quality of our questions. The key, he explained, is for advisers not to ask too many questions, not to give too much advice – instead, ensuring they spend time connecting with clients especially in the early parts of the relationship. He introduced the idea of the PEARLS skills – Probing, Empathy, Attending, Responses, Listening and Summarising – as good tools to help build trust. Delegates then practiced with each other, testing various types of responses to see the difference a good response can make.

Tim Farrelly, principal of asset allocation research house, farrelly's Investment Strategy, discussed a number of "tricks of the trade" for communicating well with investors, that he's become aware of through his work with his adviser clients. Some of these included teaching

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investors that they don't own the good years- in other words, if returns are above average, it's is a windfall and shouldn't be counted as 'real money' because some might be handed back to the markets at some stage.

Delegates then workshopped what they find has worked well in communicating with their investor clients- including:

- Shut up
- Ensure the relationship is adult to adult
- Know what value you can add
- Use storytelling to communicate concepts
- Provide quarterly reports with comments
- Guide people’s eyes with a thin pen (if they look like they are not looking at the important bits of a report)
- Do home visits for existing clients (if it suits you and them)

Fredrik Axsater, San Francisco-based Global Head of Defined Contribution with State Street Global Advisers', discussed some of the common myths and miconceptions investors have around retirement and retirement planning. Recent global surveys carried out by SSgA show that over 50% of people, even those in their 50s and 60s, have not analysed how much money they need to retire or how long it will be until they can retire. Around half of accumulators would tolerate a loss of only 10% before thinking about changing their portfolio. The key take-out of the session was that investor engagement is critical in making sure their needs are met - and, a smooth journey is more important than is thought.

Simon Mawhinney, Sydney-based portfolio manager with Allan Gray, discussed the importance of culture and rigour around investment systems, structures and processes, without which it is highly unlikely an investor will maintain their beliefs through all market conditions and cycles. He advocated true long-term alignment between fund managers and investors by judging investment performance over periods of, say, 10 years, in order to allow the quality of long-term decisions to be realised.

Kajanga Kulatunga, portfolio specialist with MLC Investment Management, discussed the lack of effectiveness of many risk profiling tools currently used. He cited research which shows that even small changes in environment, such as needing to go to the bathroom, being hungry or being touched by another person before taking the test, can change results markedly. Further, our genetics account for up to 40% of our risk taking behaviour. Given that the nature of markets is that risk is not always rewarded, so that goals may not be reached for significant periods - and longer than investors may think - it pays to show expected returns and outcomes as a range, rather than a single point. This dovetails with the

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points raised by Dr Lazenby about setting a single goal being likely to lead to disappointment if not met.

For me, the greatest takeaways from Finology Forum were:

- Applying PEARLS skills – Probing, Empathy, Attending, Responses, Listening and Summarising – to interactions with clients will lead to better relationships;
- it will help us understand where our clients are at in their own minds;
- It will help ensure advice is framed so that it will be acted upon;
- Goals (be it the client's investment goals, or the expected returns of single investments) should not be too specific – expressing them as a range is better. This takes into account the nature of markets and allows us to maintain relationships if the goal is missed; and,
- The long-term should always be emphasised over the short-term. This will allow volatility to run its course and let the quality of advice be proven.

The full proceedings of Conference 2014 Finology Forum – including presentation podcasts, sync'd slides and papers – will be available on the the Conference 2014 Resources Kit.

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