

# ADDRESSING INVESTORS' EMOTIONS





**Uncertainty and volatility often lead people (and investors) to make irrational decisions that they tend to regret once conditions move back to a normal state.**

Here are some of the most common mistakes investors make during highly volatile times:

1. Allow anxiety to dominate long-term decision making – As a consequence, they are tempted to buy high and sell low
2. Engage in “Cocktail-party investing” – They feel more secure buying securities that are in favor, ignoring the risk/return profile that those investments have
3. Overlook diversification – They tend to consider new investment opportunities in isolation without analyzing how they fit in their portfolios from an overall risk perspective

As a portfolio manager or financial advisor, how can you speak to your clients to help them alleviate their anxiety and avoid these mistakes?

## VALIDATION

Show them that you understand and support their feelings. Validation doesn't necessarily mean agreeing with their fear, rather it involves recognizing and accepting their concerns and emotions.

As you validate your clients' feelings, make sure you follow the six validation levels identified by Psychologist Marsha Linehan, Ph.D. in chapter 17 of “Empathy Reconsidered: New Directions in Psychotherapy” by Arthur C. Bohart and Leslie S. Greenberg.

- **Be present** – Pay complete attention to your clients' words in a non-judgmental way. Listen with your whole mind and avoid multi-tasking (e.g. checking emails or glancing at your phone) during the conversation. Acknowledge your clients' emotions as opposed to ignoring or avoiding them.
- **Accurately reflect what you heard** – Summarize what you've heard from your clients about the way they feel. As an example, you could say: “It seems as though you are very frustrated with how the markets have reacted recently.” Clients will feel that you are trying to understand their emotions.
- **Mind-read** – Put yourself in your clients' shoes and try to guess what they are feeling or thinking. Then name their emotions – for instance, you may say: “I'm guessing you are feeling anxious and worried as a result of these highly volatile markets.” Keep in mind that you might guess wrong and your clients may correct you. Accepting their corrections is validating them.

- **Understand behavior as a consequence of history and biology** – Interpret your clients' behaviors in the context of past experiences. If your clients lost money during volatile markets in the past, they are more likely to be worried about such thing happening again now.
- **Normalize reactions** – Help your clients realize their reactions are normal. Let them know that many investors become anxious and fearful during volatile times, and that it is totally understandable to feel that way.
- **Apply radical genuineness** – Try to understand your clients' emotions on a deeper level and share a similar experience you have had or are currently going through. If you invest your money alongside your clients', let them know that you know exactly how it feels to be an investor in this market environment.

## COGNITIVE BEHAVIORAL THERAPY

Once you have validated your clients' feelings, you may want to engage them in more positive thinking by using a simplified version of what psychologists call cognitive behavioral therapy.

According to mental health and well-being nonprofit [HelpGuide.org](https://www.HelpGuide.org), “Cognitive behavioral therapy (CBT) is the most widely-used therapy for anxiety disorders. It addresses negative patterns and distortions in the way we look at the world and ourselves.” The basic premise is that our thoughts —as opposed to the events themselves— affect the way we feel.

You may want to use the cognitive behavioral approach to identify the negative thinking patterns of your clients that contribute to their anxiety, and replace them with more positive and realistic thoughts.

The communication involves three steps:

- 1. Identify clients' negative thoughts**
- 2. Challenge these thoughts**
- 3. Replace them with realistic thoughts to create a more positive perception**

An example is shown below:

## CHALLENGING INVESTORS' NEGATIVE THOUGHTS

### **Negative thought #1: What if volatility remains and markets don't ever recover?**

Cognitive distortion: Predicting the worst.

More realistic thought: Volatility is a temporary condition and markets tend to recover from downturns, so it's unlikely that this volatility will continue forever.

### **Negative thought #2: If I lose the value of my investments, it will be terrible!**

Cognitive distortion: Blowing things out of proportion.

More realistic thought: Your investments may lose value temporarily, but it is likely that they will recover over the long term. Our investment strategy is doing what it has been designed to do, and as market conditions improve, so may the value of your investments.

### **Negative thought #3: I've made poor investment decisions.**

Cognitive distortion: Jumping to conclusions.

More realistic thought: Stay focused on the long term. You didn't sign up for selling low. This may be a good opportunity to buy cheap and remain patient as the markets begin to recover.

This communication exercise may help change investors' negative perceptions during volatile times.

As Ph.D. Psychologist Karyn Hall says, "... perceptions are often inaccurate, particularly in emotionally charged situations."

Hall explains that perceptions lead to confirmation bias. "When you have an idea in your mind you tend to look for evidence that supports that idea and not pay attention to evidence that says the idea isn't accurate." Therefore, it is important that you provide your clients with information that they may overlook in times of uncertainty, such as historical data showing how the markets have recovered from previous downturns.

These validation and cognitive behavioral therapy techniques may help you communicate more effectively with clients during times of high market volatility. Effective communication strategies during sensitive times may strengthen relationships and build greater trust.



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