Morgan Stanley

Navigating the Emotional Side of Wealth Management

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Successful long-term financial well-being requires logical decisions matched with discipline over time. However, many people allow another element to take over their decision making and potentially derail a sound financial plan: emotions.

Behavioral finance is the study of how emotions and cognitive biases can affect investment outcomes. And when addressing the topic of money, emotions often influence investors' perspectives and actions. Understanding how emotions play a role in our clients' financial journey is important for building prosperity.

Emotions Can Affect Financial Outcomes

Everyone carries psychological biases that inform what they do and the decisions they make. As a result, people are not always rational in their actions. When making decisions, people first decide with their emotions

and then their logic will kick in.[i] So, to make sure that you base your actions on a rational foundation, you must overcome emotional tendencies.

Common behaviors include:

- **Herd mentality:** Acting based on what others are doing.

  Example: Investing with the following mindset, “My neighbor is really smart. He bought ‘ABC’ stock, which performed really well. I want to buy it, too.” Instead, the investor should understand that their financial needs and profile may be very different than their neighbor’s. So, that specific stock may not be the best choice for their portfolio. To help our clients avoid this approach, we tailor portfolios to help meet their financial objectives while mitigating risk.

- **Emotional gap:** Acting based on an extreme emotion, such as fear.

  Example: When the pandemic first hit and the markets fell, many people panicked and sold stocks. To help our clients overcome this scenario, we strive to build their portfolios to withstand volatility, and we continually monitor them to help make sure the portfolios align with our clients’ risk tolerance. Further, we are ever present in communicating with them on how a short-term event can impact their long-term projections.

- **Status Quo:** Preferring things to stay the same and doing nothing for fear of making a wrong decision rather than taking action.

  Example: When an investor continues to own a stock at a loss fearing that the stock will go up if they sell it. However, there are everchanging economic and tax landscapes that affect client portfolios. At SoundView, each year, we look to take advantage of new opportunities that help us reposition investments toward clients’ goals.

- **Confirmation Bias:** Acting by seeking information that supports your beliefs and ignoring information that contradicts them.

  Example: An investor who only invests in a few companies because they rely on limited information that supports their position is ignoring the importance of diversification. Diversifying your investments simply means making sure all of your money isn’t in just one financial “basket”. Diversification seeks to provide a shield to investors and better risk-adjusted returns by smoothing out the bumps that occur during difficult investment environments. Our investment process incorporates information from both internal and external resources, and a final review and execution that reflect each client’s individual needs.

For reasons like the above examples, we believe the average investor historically performs worse in the stock market than what the markets average for returns.[ii] Why? Their emotions may get in the way.

Emotions Can Also Affect Your Financial Advice

While investors must be aware of how their emotions affect their decisions, the same scenario rings true for the guidance you receive.

From our perspective, people gain the best possible financial outcomes when they receive unbiased, educated recommendations that look out for their best interests. Sound, long-term investing requires objectivity — and the ability to help pursue our clients' goals in any financial climate.

When faced with a market draw down due to a pandemic, natural disaster, or geopolitical event, clients may experience vast ranges of emotions — both personally and financially. Our job is to understand their reactions and work with them to think objectively and stay invested in the market. We are able to do so because, throughout our relationship, we've helped to guide each client toward rational decision-making. We also help them anticipate how different decisions can affect their long-term financial plans by grounding their strategies in logic rather than emotion when the markets fluctuate.

A Stable Financial Foundation

At SoundView, we understand that life inherently brings many ups and downs. And a natural human response to new and challenging circumstances is to react emotionally. However, in every step, we aim to help our clients know how to balance judgment with reason — and to build their financial life with confidence. This way, each person gains a stable foundation for building their short- and long-term goals, no matter what life throws their way.

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[i] https://www.gsb.stanford.edu/insights/feelings-first-how-emotion-shapes-communication-decisions-experiences

[ii] https://www.the balance.com/why-average-investors-earn-below-average-market-returns-2388519