

**2020 Investor Research Special Report:
Investor Behavior in a Market Crisis**
June 4, 2020



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Investor Behavior in a Market Crisis

Tim Whiting | June 4, 2020

“If you can look into the seeds of time and say which grain will grow and which will not, speak then unto me.” -William Shakespeare

Introduction

Behavioral finance is built on two main premises. How people think (cognitive psychology) and when markets will be inefficient (limits to arbitrage). One of the reasons financial advisors and investment professionals have taken a keen interest in behavioral finance is, quite frankly, to prevent their clients from behaving badly.

Warren Buffet was once quoted saying, “We all know the easiest way to lose weight. Eat less and exercise more.” Investors have no problem completing the sentence “buy low and _____.” But history shows, time and time again, that investors, and those looking to shed a few pounds, repeatedly make the wrong decisions. Bad decisions. They do not “buy low and sell high” because they are influenced by many forces especially their personal biases, which negatively impact their decision-making. This often occurs despite excellent professional advice. Our behavior

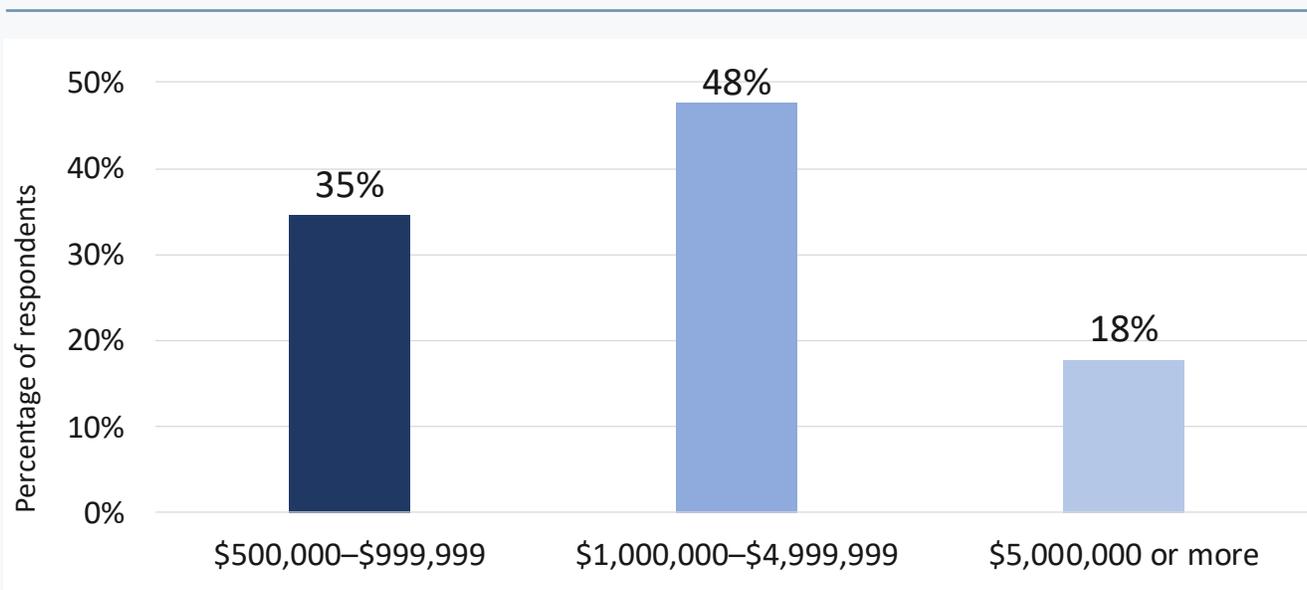
can have a disastrous impact on our portfolios and the performance of those portfolios. However, by understanding these behavioral biases and influences, we can help minimize investors’ bad behavior.

In mid-2019, Toews’ Behavioral Investing Institute, and Investments & Wealth Institute discussed fielding an investor survey with Absolute Engagement, to deepen our understanding of investors’ mindset, particularly during periods of market declines. We did not expect that the outbreak of COVID-19 would occur during the fielding of the survey in March 2020. As a result, we had the fortuitous coincidence of asking investors about investor behavior during a crisis, in the midst of the most significant financial crisis since The Great Depression. Of all prior infectious disease outbreaks, not even the 1918 Flu Pandemic has impacted the financial markets as dramatically as COVID-19, and the story is far from over.

Advisor Guidance for Clients

So, what can advisors do when dealing with their clients to help them with during period of uncertainty? Let us dive into the results of our survey of 751 investors in the United States. Input was gathered between March 10 and March 24, 2020. Please note that all respondents worked with a financial advisor, made, or contributed to the financial decisions in their households, and met specific requirements regarding household investable assets.

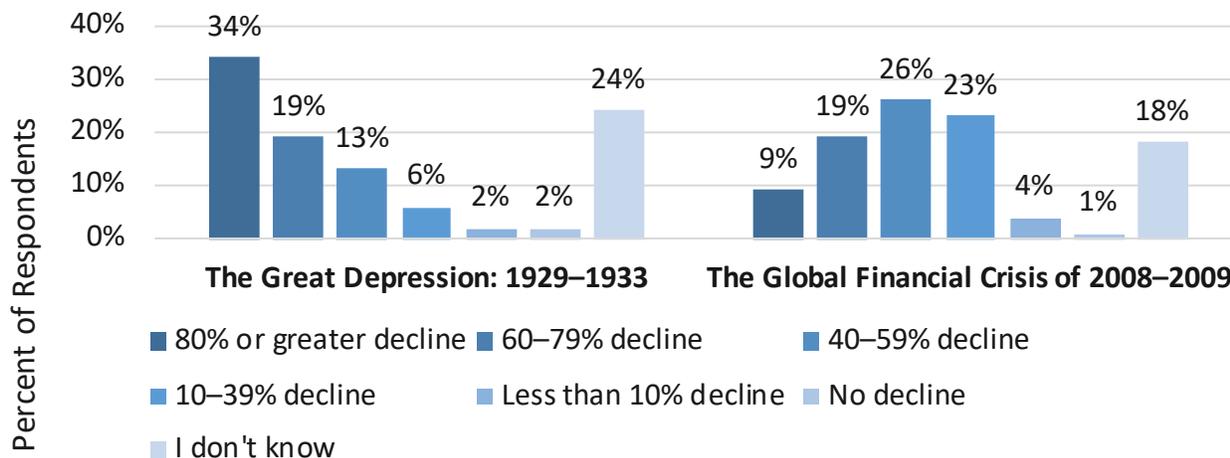
Q: Please tell us which best describes your current total investable assets?



Investor Knowledge

Most investor respondents felt they are knowledgeable with respect to investing or the markets. However, when they think about periods of significant market turmoil, 34 percent felt that The Great Depression (1929–1933) had an 80 percent or greater decline, while only 9 percent felt The Global Financial Crisis of 2008–2009 had an 80 percent or greater decline. Fifty-three percent felt the markets declined 60 percent or more during The Great Depression, compared to only 28 percent during The Global Financial Crisis of 2008–2009. Interestingly 24 percent responded “I don’t know” about maximum losses during The Great Depression and 18 percent for The Global Financial Crisis of 2008–2009. This suggests that although advisors may understand these historic market events and their declines, significant portions of their client base do not. However, in general, investors understood the significance of The Great Depression.

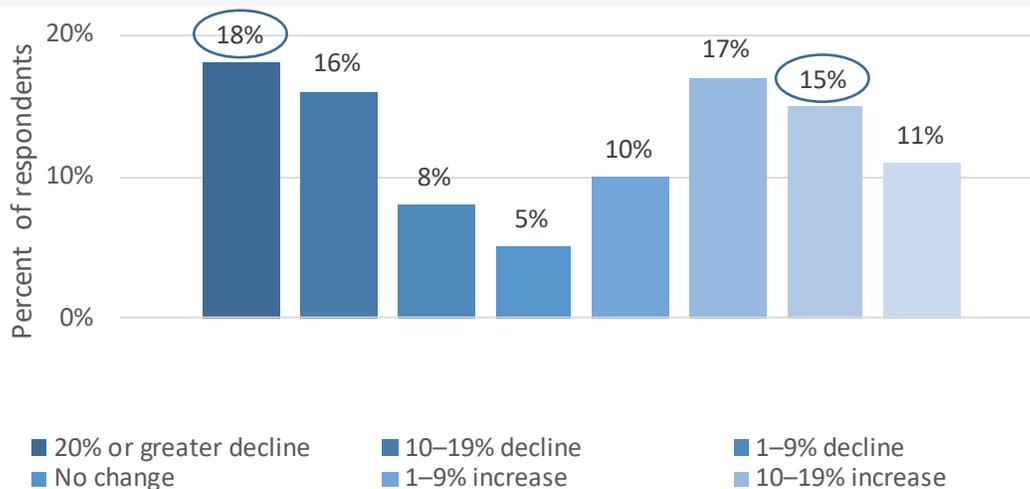
Q: What were maximum stock losses during the two time periods below?



Client Performance Expectations

We asked investors about the stock market performance the past 12 months (approximately April 2019 to March 2020) and the responses showed little consensus. A similar percentage of respondents felt the market was down 20 percent as those that felt it increased 20 percent (18 percent versus 15 percent respectively) suggesting most investors did not know, or that they are looking at very different information.

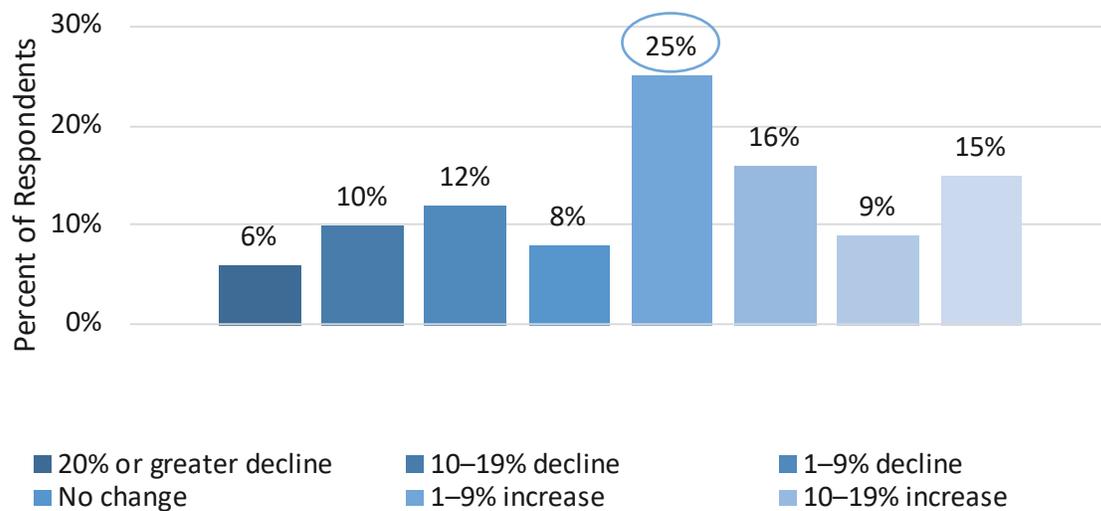
Q: How has the stock market (S&P 500) performed in the past 12 months?



Expected Portfolio Rates

Looking at expected portfolio rates of return for the next 12 months (March 2020–February 2021), investors were extremely optimistic with 25 percent expecting increases of 1–9 percent and one quarter expecting increases of 10–20 percent or more. Only 8 percent felt there would be no change and 15 percent did not know.

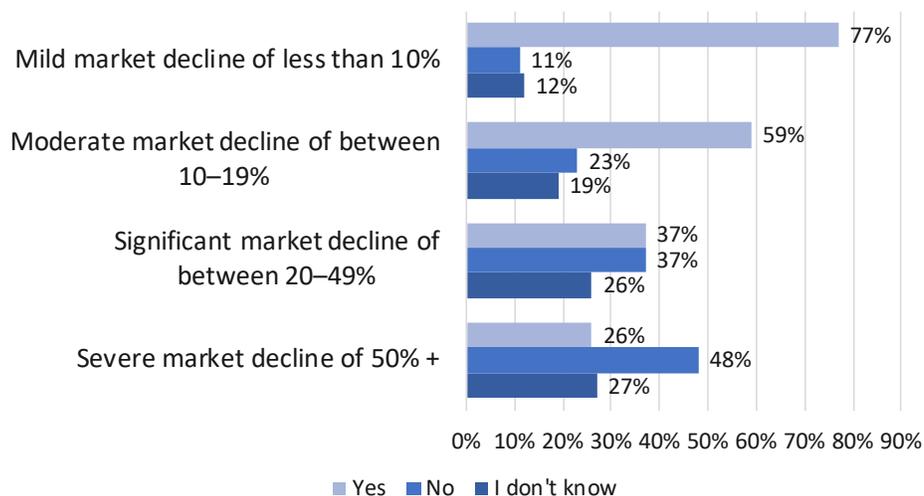
Q: What rate of return do you expect to earn on your portfolio in the next 12 months?



Retirement Goals

Views on achieving retirement goals in market declines showed most investors would achieve their retirement goals even with mild to moderate market declines. However, in a significant market decline 37 percent said they would meet their goals and 37 percent said they would not while 26 percent said they would not know. This suggests investors have more concerns about their retirement during periods of significant or severe market declines and an opportunity for advisors to provide more retirement planning advice.

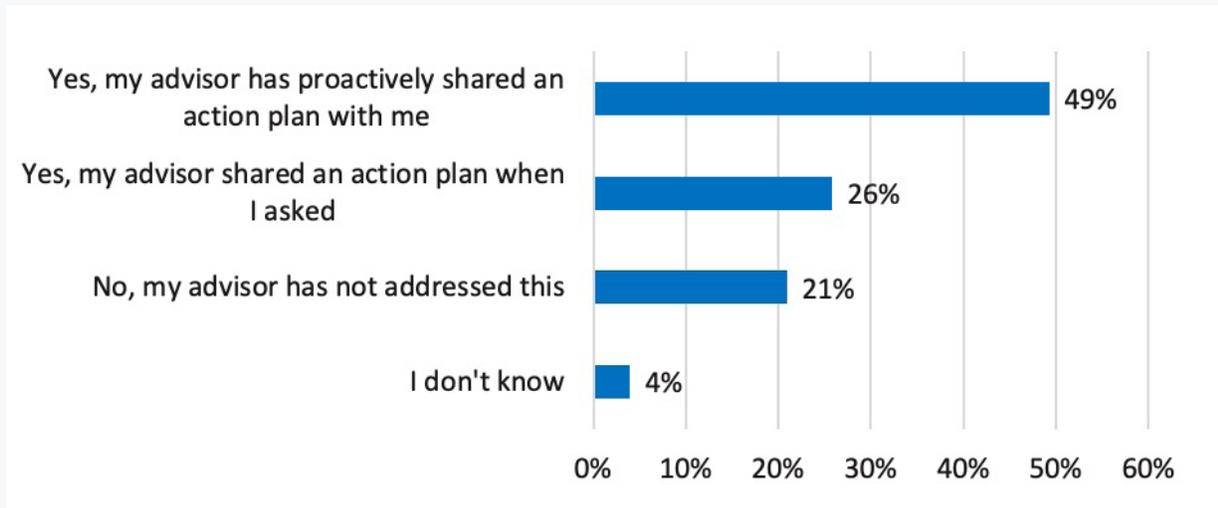
Q: Do you believe you will still achieve your goals for retirement should we experience any of the following?



Do you have a clear plan?

Two-thirds of investors feel they have a clear plan of action for their portfolios in periods of severe market declines or other market disruptions. This speaks highly about the effectiveness of the advisory profession to provide a level of confidence for their clients. About half (49 percent) said their advisor has proactively shared an action plan with them in the event of a significant or severe market decline and 75 percent of respondents indicated they have an action plan. Advisors could do a better job providing clarity of their plans given that investors are aware they have a plan but do not always feel it is a clear plan.

Q: Has your advisor addressed what actions should be taken in your portfolio in the event of a significant or severe market decline?

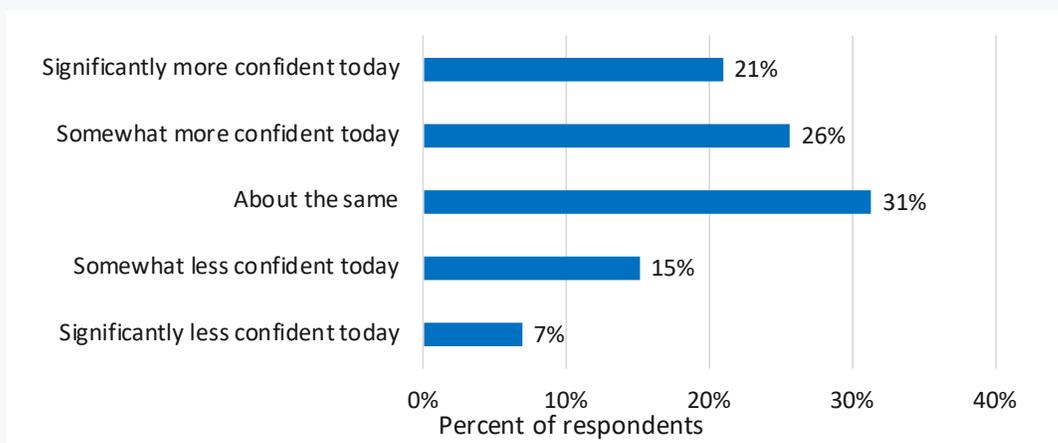


Peace of Mind

For those investors who have a plan, 36 percent said having a plan had a significant positive impact on their peace of mind and 52 percent said there was some positive impact. For those investors who did not have a plan in place, 10 percent said this would have a negative impact on their peace of mind, 48 percent said it would have some negative impact, and 42 percent said it would have no impact on their peace of mind. Here is another opportunity for advisors to improve peace of mind with clients by implementing clear plans.

Of those investors who were invested in the markets between 2008 and 2009 (85 percent of respondents), about half (47 percent) said they were confident in their financial future today compared to how they felt prior to 2008 and 31 percent said they felt about the same.

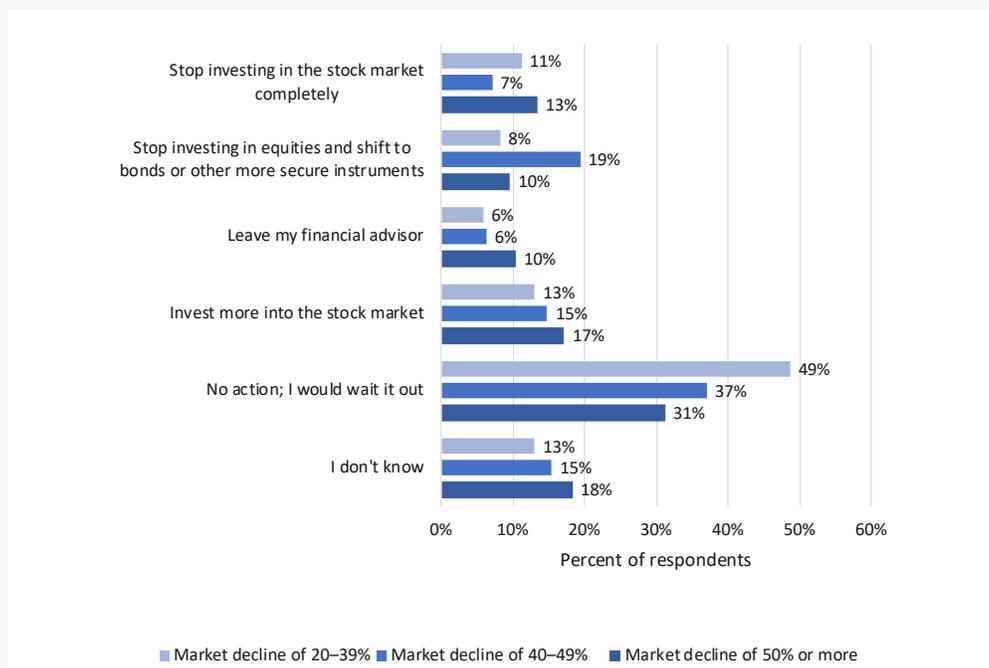
Q: How would you describe your level of confidence in your financial future today, compared to how you felt prior to 2008?



Response to Market Declines

During the financial crisis of 2008–2009, the S&P 500 dropped by 55 percent. We asked investors how they would respond if they were to experience market declines of 20–39 percent, 40–49 percent, and 50 percent or more, for a period of up to two years. Client loyalty would be negatively impacted; investors responded saying they would be more likely to leave their financial advisor the greater the market decline. With a market decline of 40–49 percent, almost one-fifth of investors said they would stop investing in equities and shift to bonds or other more secure instruments. In a severe decline of 50 percent or more, almost one-third would “wait it out” versus 49 percent who would wait it out if the market declined 20–39 percent.

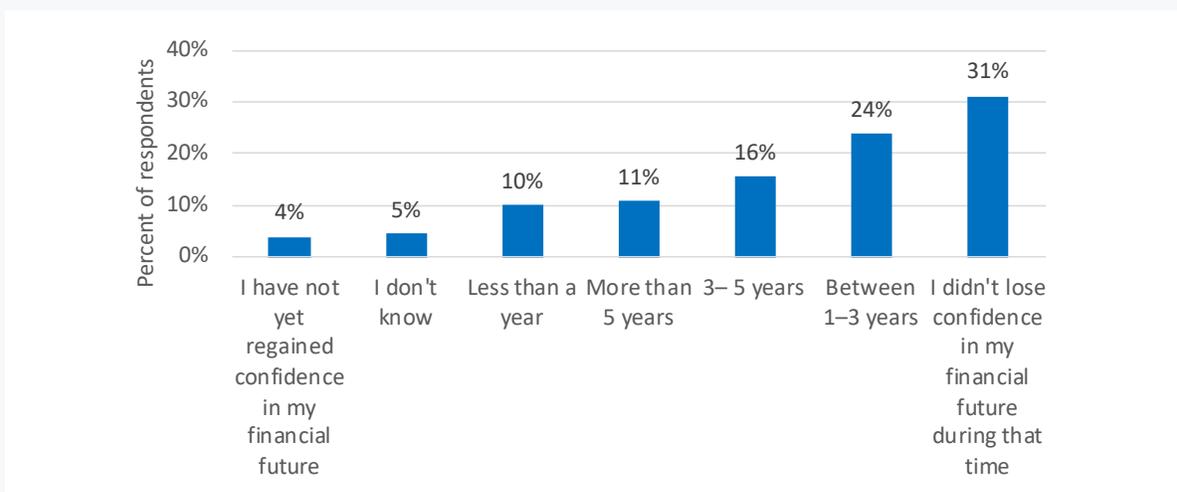
Q: If the market fell by the amounts noted below and for a period of up to two years, what are you most likely to do in response?



Regaining Confidence Post Crisis

We asked investors how long it took to regain their confidence in their financial future after the 2008–2009 crisis. About one-third did not lose any confidence, about one-third took up to three years to regain confidence, and one-third more than 3 years; 4 percent responded saying they still have not regained confidence in their financial future.

Q: How long after 2008–2009 did you regain confidence in your financial future?



Advisors' Strategies to Protect Investments

The top strategies that advisors took to protect their clients' investments during the 2008–2009 crisis include:

1. Adequate bond allocations in the portfolio at the beginning of the crisis to help offset stock losses (37 percent).
2. Alternative strategies as part of the portfolio at the crisis onset to help offset losses (35 percent).
3. Hedged equities or loss-avoidance strategies were part of portfolio at crisis onset to help offset losses (21 percent).
4. Exited stocks to reduce losses during the crisis (20 percent).

If hindsight were 2020

Would investors have done anything different during the 2008–2009 crisis? More than half (55 percent) said no, 29 percent said yes, and 16 percent responded that they did not know. Of those who answered yes, the following is how they would have rethought their approach:

- 44 percent would have exited stocks to lessen losses.
- 42 percent would have added alternative strategies to their portfolios at crisis onset to offset losses.
- 39 percent would have had higher bond allocations in their portfolios at the beginning of the crisis to help offset stock losses.
- 34 percent would have added hedged equities or loss avoidance strategies to their portfolios at crisis onset to help offset losses.

Risk Tolerance and Returns

Looking at returns versus losses in a negative market, two-thirds of investors would accept lower returns if they were confident that the probability of experiencing significant losses due to negative market events would be lowered. Only 11 percent disagreed and 21 percent were neutral. Looking deeper into this response, the more assets investors have (e.g., \$5 million plus) and the further out from retirement they are, the more they agree with accepting lower returns for less risk. Also, the better investors felt about their advisory relationships (strong advisory relationship), the more willing they were to accept lower returns.

Conclusions

The goal of our research was to better understand how investors behaved in times of prior market turmoil. We wanted to understand their feelings, confidence (or lack thereof), advisor relationships, and actions they took (or might take) with their portfolios. When we deployed the survey in early March 2020, we had no idea that we would be entering a period of extraordinary market declines. This provided us with results that were even more meaningful and insightful. The fortuitous timing of this survey has provided a unique look at investors' behavior under the conditions that we are continuing to experience and may for some time. We were surprised that most respondents understood the significance and impact of The Great Depression, although 24 percent did not know the percentage market decline. There were mixed responses to The Global Financial Crisis of 2008–2009, however,

most investors regained their confidence in the markets within three years. Looking ahead to the next 12 months, half of investors expect to see positive rates of return in their portfolios and one-third expect to see declines. Except where there may be extreme market declines of 50 percent or more, investors seem secure about their futures, their retirements, and their advisors. Where advisors could do a better job is providing more clarity on their advisory and investment plans. Investors are more confident when the relationship with their advisor is strong. There is value and peace of mind having strong plans, but many investors did not find these plans to be clear. Almost one-third of investors wish they had taken different approaches in 2008–2009, and they are less confident in today's market conditions. Now, advisors should be having more conversations about client expectations, accepting lower returns for less risk, and offering advice on rethinking their approach. This may include exiting stocks, adding alternative strategies, changing allocations more to bonds, or adding hedged equities or loss-avoidance strategies to their clients' portfolios. ●



About The Behavioral Investing Institute

Toews' Behavioral Investing Institute, provides behavioral finance training for advisors through workshops, seminars, and coaching. The Behavioral Investing Institute's workshops and seminars provide implementation ideas that will enable the audience to improve on their ability to recondition their clients' perception and emotional response to various market cycles. Our one-year coaching program guides advisors through a training framework that seeks to change investors' default emotional responses to various market challenges. Each student in the coaching program will have ongoing access to their personalized behavioral guidance tools and analysis, as well as stay current on the ongoing evolution of our tools as they develop. Upon completion of the Behavioral Finance Coaching Program, financial advisors become part of a community of investment professionals committed to ongoing learning in the field of behavioral finance.

For more information, visit www.biicoaching.com.



About Toews

Toews Asset Management is an SEC-registered investment advisor founded in 1994. Most investors hope to avoid losses and realize growth. Toews builds portfolios that primarily seek to reduce risk of loss in crisis environments, as well as attempt to participate in market gains.

Our process is not based on subjective or predictive methodology. It has used a heavily researched and price-reactive algorithm since 1996 that provides a signal for investment exit and re-entry points.

For more information, visit www.toewscorp.com.



About Absolute Engagement

Absolute Engagement is an organization that prides itself on being an expert in elevating the client experience and helping advisors drive practice growth. Founder and Chief Executive Officer, Julie Littlechild, is a recognized expert on the drivers of client engagement and a popular speaker on how client experience is being disrupted and how to leverage those trends to drive referrals. Ms. Littlechild has presented at numerous Institute events, both in-person and online. She has worked with and studied successful financial advisors and their clients for more than twenty-five years. Previously Ms. Littlechild launched and ran one of the industry's leading research firms, focused on client engagement. She is the author of a popular blog, the co-host of the *Becoming Referable* podcast, and the author of *The Pursuit of Absolute Engagement*. For more information, visit www.absoluteengagement.com.



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