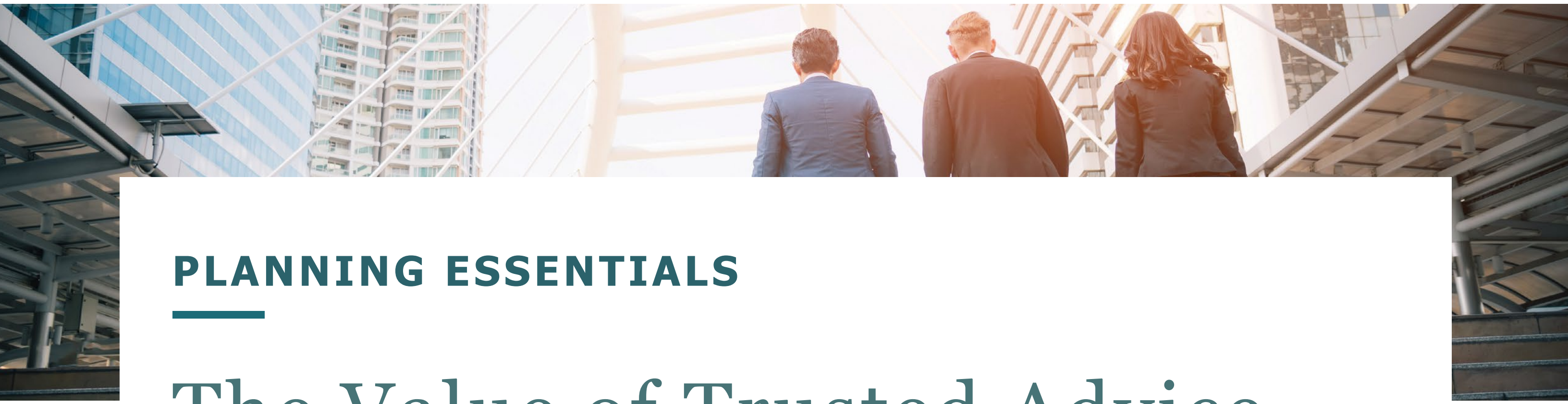
Eagle Strategies LLC

Financial Planning



PLANNING ESSENTIALS

The Value of Trusted Advice in a Turbulent Market

From 1991 to 2021, the S&P 500® achieved an impressive average return of 10.65% annually. Over the exact same period, however, the average equity investor realized an average annual return of just 7.13%.[1]

It may not seem like a substantial difference at first glance, but that 3% translates to over a $1.2 million difference where the average investor has $800,000 and the S&P 500 would return over $2 million in the same period.

KEY TAKEAWAYS:

A recent study shows that much of the value associated with working with an advisor comes from his or her ability to help you manage your emotions when making financial decisions.

Behavioral biases are the main reason why most investors underperform broad market indexes like the S&P 500.

These biases tend to be especially problematic during times of severe market volatility.

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Too often, we let emotions cloud our judgment—buying stocks when the market has become overpriced, selling stocks when their value has already fallen, or holding on to our "losers" while we sell our "winners." We simply need to do a much better job of avoiding these common pitfalls. And, as is always the case with overcoming any bad behaviors, the first step lies in identifying and acknowledging our "less than optimal" actions.

WHY TRUSTED ADVICE MATTERS

Most of us know the intrinsic value of expert advice—whether it's regarding our health status, our tax liability, the preparation of our legal documents, or the management of our wealth. However, perhaps the greatest value of trusted advice lies in its ability to prevent you from making decisions based on your emotions rather than evidence. Cognitive biases aren't something that other people suffer from —we all do.

A study conducted by Vanguard found that while 55% of the value associated with financial advice was "functional" (i.e., creating a financial plan, building and managing an investment portfolio, rebalancing, and other planning services), nearly half (45%) of the value was derived from helping to manage the investor's emotions.[2]

When you work with an advisor to create a comprehensive financial plan that addresses both your short- and long-term goals, it functions much like the guardrails on a highway—keeping you moving in the right direction and preventing your emotions and biases from leading you astray.

It's the people who go against the grain who often come out on top. To do that, however, requires considerable patience and a thoughtful plan. This can be especially challenging during times of extreme market turbulence when the smartest long-term investment decisions may not necessarily lead to the best short-term results. Remember: thoughtful, strategic financial planning is a marathon, not a sprint.

UNDERSTANDING YOUR BIASES

Established back in the 1980s by psychologist, economist, and Nobel Laureate, Daniel Kahneman, the field of behavioral finance has evolved greatly over the years. Thanks to the work of visionaries like Kahneman and Richard Thaler, as well as a new generation of behavioral economists including Shlomo Benartzi, we now have a much better understanding of dozens of biases that frequently short-circuit our financial decision-making when volatility rears its head in the markets. Here are just a few of the most common biases:

Herding bias: From prehistoric times when straying from the pack and exploring the unknown could literally be lethal, the tendency to follow the crowd financially (even when it may not be in our own best interest) seems almost hardwired into our human DNA. From the Dutch "tulip mania" of the 1600s to the dot-com bubble of the late 1990s, and most recently the astronomical rise and equally rapid descent of Bitcoin, history is littered with examples of our eagerness to jump on the latest trend to appease our innate FOMO (fear of missing out).

Overconfidence bias: We tend to overestimate both what we are capable of as well as how much we know. Look no further than the oft cited 1980s psychological study which found that, despite the statistical impossibility, more than nine in ten Americans consider themselves "above-average" drivers. We reinforce this behavior as a society by valuing certainty over uncertainty—nobody ever wants to hear "I'm not sure" from their physician. Overconfidence explains why we typically expect good things rather than bad things to happen to us and is the main reason (along with loss aversion) we tend to sell our successful investments too early and hold on to our bad investments too long.

Status quo bias: We are creatures of habit who generally prefer the comfort of the familiar. Change can be intimidating, so rather than face the unknown, we tend to procrastinate and put off making important decisions. It's one of the primary reasons why it can be difficult to convince an investor to build up an emergency fund or to create a plan to cover potential long-term care costs. In tandem with our "loss aversion bias," it also explains why so many 401(k) savers maintain the same salary deferral percentage and default conservative allocation despite a steadily rising income.

Recency or availability bias: Explains our inclination to place far greater importance on recent news and events, rather than focusing on longer-term trends. It's why 11+ years into the last bull run, so many investors forgot about the cyclical nature of the stock market. Fueled by the almost constant 24/7 onslaught of financial news (both online and through media outlets), recency bias also tends to lead investors to flee the market after a precipitous correction, thus missing out on the ensuing recovery.

Through the simple act of recognizing and understanding these biases, you can make tremendous strides towards overcoming them. Awareness alone, however, won't eliminate them. Constant vigilance and expert guidance will be needed.

[1] DALBAR, 2022. An investment cannot be made in an index.
[2] Vanguard Research, *"Assessing the value of advice,"* September 2019.

ES.PE.ValueofAdvice
SMRU 5636937.1 (Exp. 04/30/2025)

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