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Often, adviser biases are more important than client biases

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Portfolio
Construction
Forum



Behavioural bias

Often, adviser biases are more important than client biases

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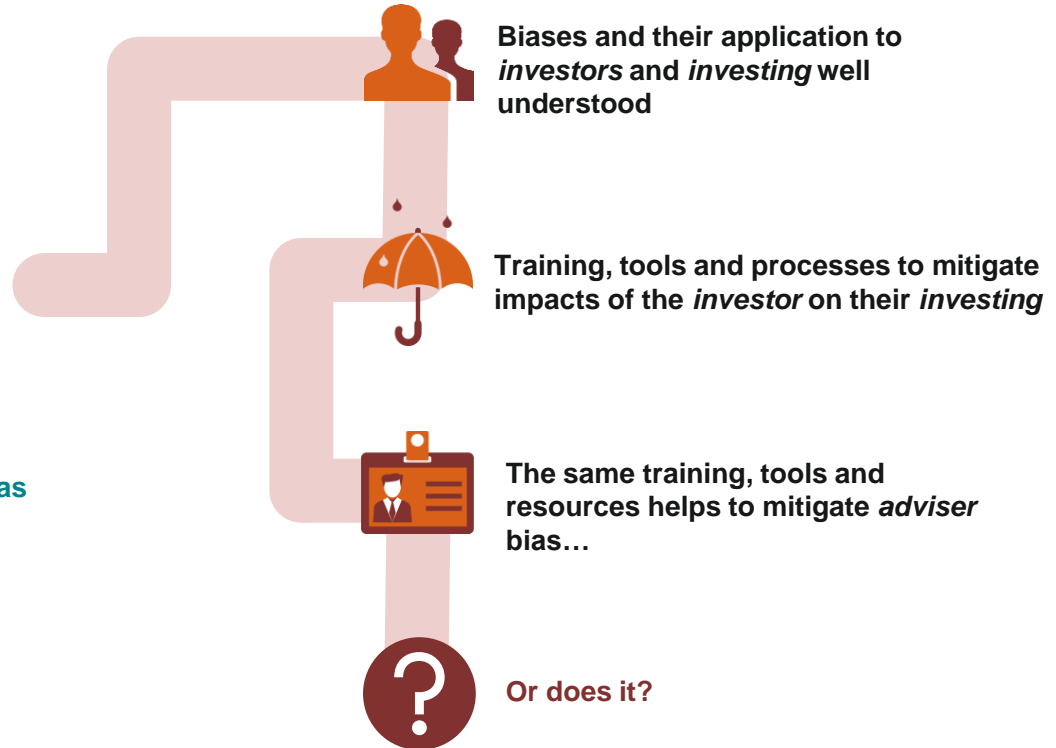
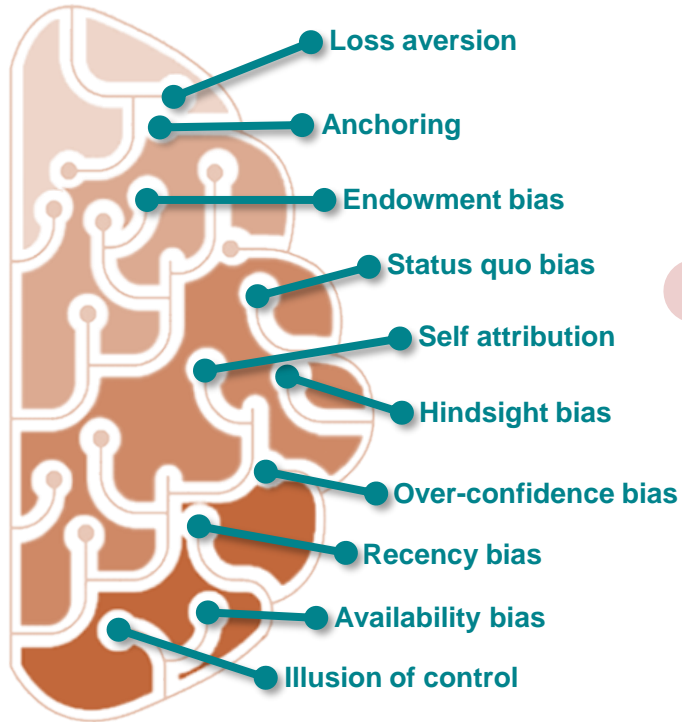
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Behavioral bias

Impacts on investment decision making



ASSET MANAGEMENT

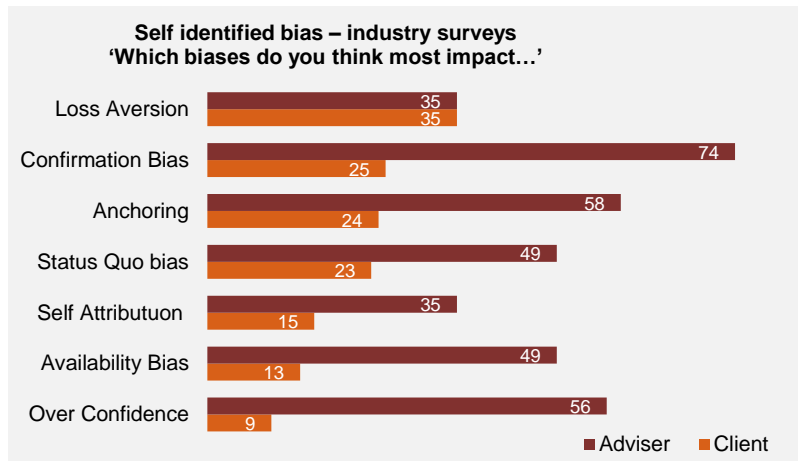


Behavioral bias

A focus on the adviser

- Research literature is fairly clear: professional investors (and advisers) are just as susceptible to cognitive and emotional bias as ordinary investors.
- Our education and training can actually exacerbate some biases.
- The differences often lie in the type of biases to which investors/advisers are most susceptible vs our clients.

- Research literature tends to be centred on investment decision making / trading (sell vs buy etc).
- Most focused on ordinary investors or institutional investors.
- Comparatively little focused on advisers.
- Even less on how these biases impact **practice level decision making** such as **adopting an investment style, designing an investment solution & client segmentation.**



* Morningstar, Bloomberg, Cerulli Associates/IMCA

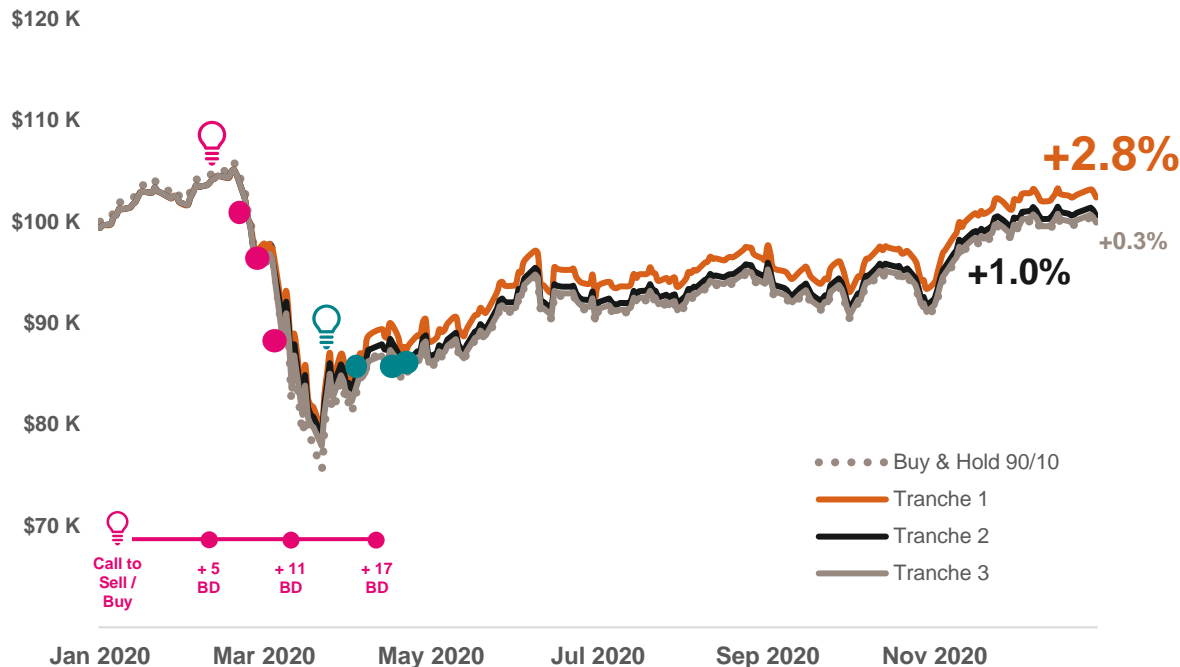


Atypical day at the office

Retail portfolio management through COVID-19



ASSET MANAGEMENT



The scenario

Simple philosophy:

- ↔ Switch between 90/10 & 70/30 passive portfolios

Generous assumptions:

- 👍 Excellent entry and exit calls
- 👍 Quick initial implementation
- 🔨 Pragmatic licensee processes & compliance.
- 🕒 Generally responsive clients

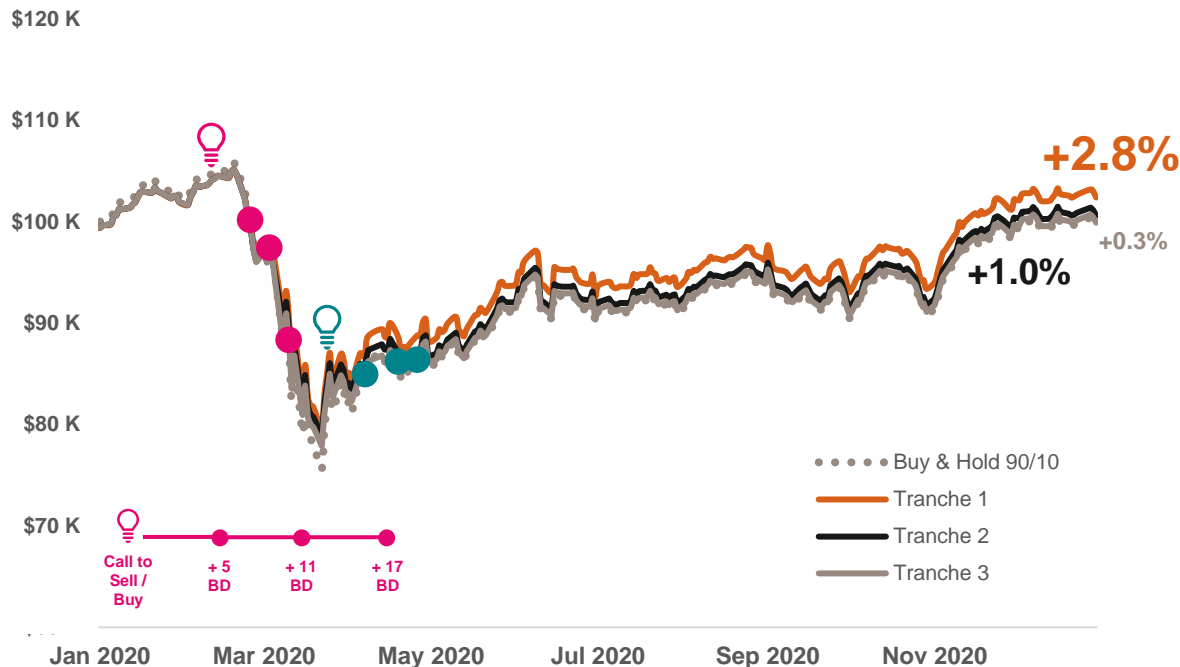
BUT.....

- 🐢 portfolio management remains a manual advice process

Hypothetical \$100k portfolio modelled on daily returns between 02/01/20 and 31/12/20 using allocations to Vanguard High Growth (90/10) or Vanguard Growth (70/30) managed funds. Scenario switches assume 100% movement between options at points indicated. Gross of any trading costs and taxes are assumed. Past performance is not indicative of future performance.

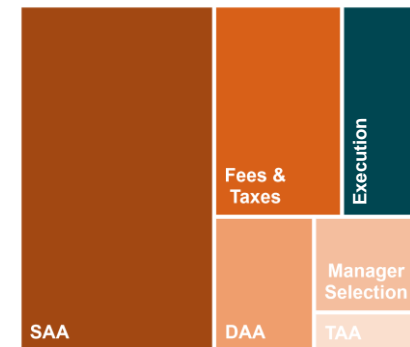
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Contribution to returns



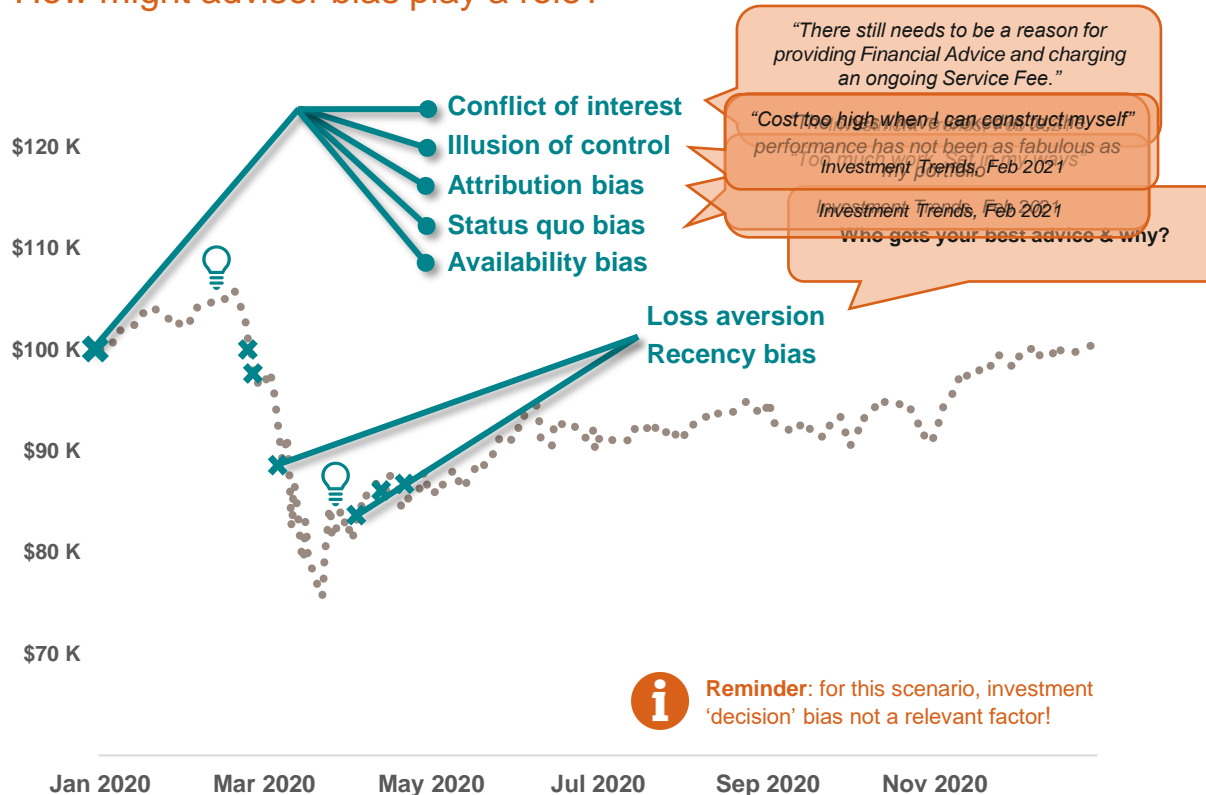
* Conceptual allocation of return drivers

- Portfolio execution can have a sizeable impact on portfolio returns
- Potentially more so than DAA, TAA or Manager selection.
- Despite being less complex and offering greater certainty of outcomes.
- **Yet, it receives far less attention**

Why?

Atypical day at the office

How might adviser bias play a role?



Reminder: for this scenario, investment ‘decision’ bias not a relevant factor!

Key decision points

- **The trade**
 - Near perfect call
- **Investment model/process design**
 - Core investing beliefs
 - Philosophy & investment policy
 - Portfolio design & construction
 - Execution = manual model portfolio
- **Client prioritisation**
 - Driven by administration reality
 - Forced segmentation?

Hypothetical \$100k portfolio modelled on daily returns between 02/01/20 and 31/12/20 using allocations to Vanguard High Growth (90/10).

Atypical day at the office

Examining the outcomes



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Clients:

- Portfolio outcomes ranging from great to poor (before costs!)
- Additional administration burden
- Increased stress & anxiety
- Average client experience

Adviser & Practice:

Disparity of client outcomes

- Outcomes inconsistent with 'house' model returns
- Multiple / conflicting portfolio narratives
- Significant administration & communication burden
- Risk of administration & implementation errors
- Dilution of portfolio management value proposition

Behavioural
bias risk

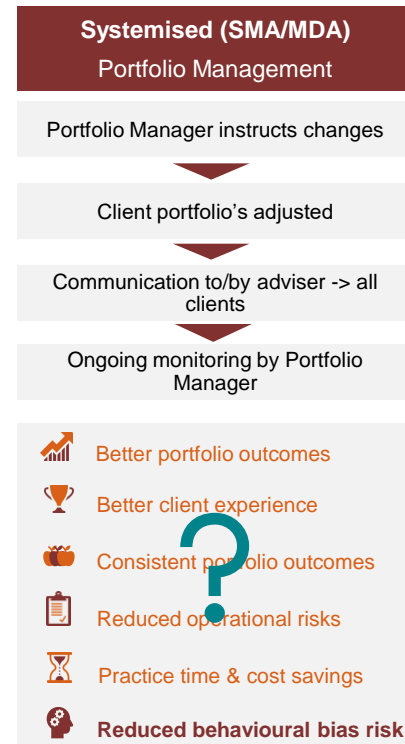
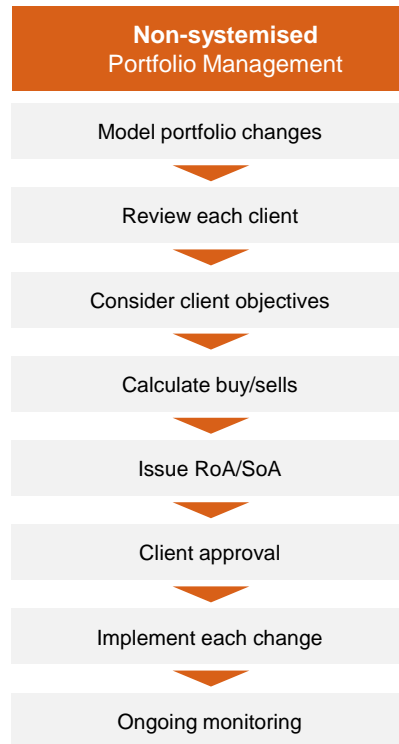
Clients =
Increased

Adviser =
Materialised

Behavioral bias

Solution mode

- Cognitive and emotional **biases exist and persist for a reason**, awareness is rarely enough to consistently overcome them
- Establishing **systems and processes external to ourselves** can be an effective mitigation strategy.
- As Advisers, you implement it for clients every day
 - *regular contributions*
 - *'pay yourself first' budgeting*
 - *dollar cost averaging*
 - *automatic rebalancing*
 - *Delegation to you!*
- **Thoughts on our example scenario....**



Further research

Where to from here?



Consider your current portfolio management & execution processes

Are they delivering the best outcomes for your clients and your practice?



Where can you go to explore your options?

- Your chosen platform provider
- A trusted fund manager
- Industry groups (e.g. IMAP)



Additional reading:

Seven Sins of Fund Management
James Montier, Feb 2006

Mitigating the Impact of
Advisors' Behavioural Biases
*Charles Schwab, The Investments & Wealth Institute
(IWI)*



Additional reading: SMAs & MDAs

- 'Making the switch to managed accounts'
MLC Asset Management
- 'Two roads to a single destination'
BT Panorama & IMAP

Often, adviser biases are more important than client biases



You understand the impact of behavioural bias on investors and investing

‘Know your clients’



We have explored how these biases can manifest for adviser specific decision making

‘Know yourself’



We demonstrated how these

“Adviser biases can be more important than client biases”



The tools exist to build a more robust, consistent and efficient portfolio management process



Adoption of these tools provides the means for

improved portfolio outcomes & client experience



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continuing education, accreditation and certification

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