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WHITE PAPER

Downshift: Strategies for Managing Client Experiences in a Mature Market

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Investor sentiment is constantly changing, regression to the mean is a reoccurring and powerful force, and capital markets are too complicated to thoroughly understand or predict. In this context of uncertainty, clients bring unique combinations of desires and emotional vulnerabilities that must be managed. After several years of surprisingly robust returns, advisors who want to preserve their business must now prepare clients for the possibility of greater volatility, abiding inflation and muted returns. Financial Advisors (FAs) who don't ready their clients risk having painful discussions with disappointed investors.

In this paper, we use key insights about human decision-making and research in behavioral finance to look at the practical challenges of managing client trust during uncertain times. We discuss ways in which clients experience the markets and the role of expectations. The focus is on the impact of common heuristics—built-in shortcuts—that influence how clients approach decisions about investment volatility. The paper includes four strategies for managing client relationships more proactively and intentionally in a mature market.

Introduction

Leadership Decisions in Conditions of Uncertainty

In his book *Critical Reflection in Practice: Generating Knowledge for Care*, Dr. Gary Rolfe explains his model for understanding complex situations and how it applies to strategic planning. We use Rolfe's model as the structure for exploring current market conditions and developing a strategic plan for responding effectively.

Let's start by understanding what critical reflection really is. Rolfe tells us that it is a three-part process of defining:

1. What the current situation consists of
2. What concerns and implications are present in that situation
3. What response to those implications will be most effective

For FAs, this process can provide a structure for analyzing the complicated current conditions that may impact client relationship management. It is a simple way to focus more narrowly on the *important* information, make sense of those details and develop a response. The beauty of the three-part process is that it helps an FA communicate complicated ideas more simply.

Because the three parts of the process provide a natural way of focusing on the central information that needs to be dealt with, critical reflection has been widely adopted in medicine, in education and to organize cross-functional military leadership briefings.

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[A] heuristic is a simple procedure that helps find adequate, though often imperfect, answers to difficult questions.

Daniel Kahneman—psychologist and behavioral economist who was awarded the 2002 Nobel Memorial Prize in Economic Sciences

What?
What Is the Current Situation?

The first step in the critical reflection process is to explore the details that define what's going on in today's markets. We start with the question "What is the current situation?"

Retail Advisors Face Predictable Relationship-Management Challenges

Most client-facing FAs agree that the current climate is difficult. Investors are becoming more skeptical about the value of a full-service advisor, markets are volatile, political upheaval is rampant, and inflation fears are headline news. In this context of uncertainty, each client relationship must be managed intentionally. One way to do so is by building trust in a professional advisor-client relationship.

Begin by thinking about trust as the currency of exchange between two people. Each party trusts the other to be consistent in their regard and care for the other. More frequent positive interactions improve the quality of the relationship. However, if one party ignores the needs of the other, the relationship can sour quickly.

In the advisor-client relationship, the personal dynamic is both enriched and complicated by the business dynamic: the advisor expects to receive a payment for services, and the client expects to receive meaningful value for the payment provided. This financial exchange makes it easier for both parties to keep track of the health of the relationship, but this monitoring is complicated by the fact that much of what the client receives is intangible (in the form of confidence about the future or relief from concerns about the present) and requires delayed gratification (in the sense that a fee is paid to the advisor for results that accrue over time).

If we look at the advisor-client relationship as more than just a financial transaction and instead as a complicated combination of personal and business dynamics, we can develop a model for managing the client's appreciation of the advisor's value and for finding ways to proactively stimulate greater feelings of trust and interpersonal satisfaction.

Trust Builds Slowly Over Time

To effectively manage advisory relationships, it's necessary to understand how trust works within relationships.

First, you cannot cause another person to trust you. Trust is a label that the client attaches to his advisor as a result of a series of experiences. Some clients find it easy to trust and may need very few experiences to feel trust toward an advisor. Others find it very difficult to feel trust and after many experiences may still have trouble trusting their FA. In this way, trust is deeply personal. It cannot be caused; it can only be given.

Second, trust builds up over time through experiences. There is a huge difference in the level of trust between a client and an advisor who have worked together for 20 years versus the trust a client feels toward an advisor whom he has worked with for less than a year. An FA can build trust intentionally over time, and the more effort she invests, the more likely it is that a client will trust her.

Think of a relationship as hundreds of building blocks stacked together carefully over time. Each time the client sees the advisor consistently providing evidence of goodwill and professional competency, another block falls into place. But trust is fragile. We will talk more about this later.

Human Behavior: Unchanged for 50,000 Years

In the financial-services world, one element that is crucial to being seen as trustworthy is addressing uncertainty and the emotional challenges that come from being vulnerable in a big and often frightening world. Investors don't necessarily think in terms of investment results. Instead, they feel a larger, emotional fear. They wonder, "What steps do I need to take to protect myself from harm?"

Thousands of years ago, humans answered this question by gathering into groups, developing weapons, cultivating fields, breeding livestock, building villages and surrounding those villages with walls. These advancements were driven by the desires to increase security and minimize risk.

As civilization advanced, currency became a way to manage risk, and people began to accumulate wealth in the form of money instead of possessions. Investments were known as securities because money offered a feeling of security and certainty about the future. As people needed less protection from wild animals and invaders, they began protecting the process of accumulating wealth.

Although civilization has advanced dramatically over the past 50,000 years, despite our achievements, our brain, central nervous system and survival instincts essentially remain as they were back in the prehistoric era. The result is an odd contradiction in how humans experience money and investing: the rational, educated and modern part of the brain thinks one way while the emotional, instinctive and primitive part reacts very differently. Investors want to trust the advisor they hire for protection, but that trust remains fragile throughout the relationship.

Trust Is Fragile: Experiences Matter

Building and retaining trust require a series of positive events. Remember that advisor-client relationships are dynamic and unpredictable. All FAs are human and prone to errors in judgment, and clients are human and prone to misunderstandings. Markets are unpredictable, and the experience of investing can be painful at times.

In fact, one breakdown can destroy years of hard work. Rather than hoping that the relationship will remain positive, FAs must organize their behavior so they can regularly deliver experiences that provide evidence that trust is deserved.

Two Causes of Bad Experiences

As we have discussed, experiences are the building blocks of every working relationship. Therefore, it is imperative that we understand two bad experiences that clients can have while working with their advisor. This is a big part of an advisor comprehending the current situation.

1. **Disappointed Expectations:** People set expectations for the future. Sometimes they are realistic and obtainable; sometimes they are not. They are set inside the client's mind. If expectations are not met, the client may feel pain and no longer trust his advisor. Even if the expectations were unreasonable or irrational, the client can still feel deeply disappointed.

   To maintain a positive relationship, it is critical for an FA to manage the client's expectations of how the current situation will evolve into future outcomes. Allowing unreasonable expectations to define the relationship is likely to put that relationship at risk.

2. **Painful Surprises:** These are another kind of bad experience. An example is when the markets swing from bull to bear and the client's portfolio isn't positioned for the transition. Events like this are located outside the client's mind and catch him by surprise. Unfortunately, even when the negative experience is completely separate from the client's expectations, the client may still connect the painful experience to the advisor.

Recognize that many bad experiences that clients have with their advisors are a combination of irrational expectations and external events. These powerful forces work against the trust relationship and can be harmful. Because trust is the fundamental currency in the relationship between advisors and clients, managing expectations is critical, especially when markets are likely to be volatile.

THE TRUST EQUATION

$$T = (C + E)\ (G + PC)\ TM$$

Trustworthiness = (Consistency + Experience) (Goodwill + Professional Competency) Time

Managing Trust as a Strategy

What we have learned so far is that in any market condition:

1. Trust between a client and his advisor is fragile.
2. Experiences matter.
3. Trust must be managed in order to preserve a positive working relationship.

Let's look more deeply at that last idea. Above is a simple equation for understanding the elements of a trusting advisor-client relationship.

Consistency: Evidence of honesty, fair pricing, transparent fees and putting the client first must be unbroken throughout the relationship. One episode of inconsistency may damage the relationship permanently. In this way, trust is highly fragile but can be managed if the positive qualities that define the relationship remain unchanged.

Experience: The client must have experiences that provide continuous evidence of and reassurance in the advisor's trustworthiness. If disruptions affect the trustworthiness of the institution or transparency in pricing, the savvy advisor will proactively offer compelling evidence to restore the positive feelings. These experiences are the building blocks of trust.

Goodwill: In this case, goodwill means more than just compassion or kindness; it means the client must see that the FA protects his interests from harm. It implies vigilance against different types of dangers and how protections are provided. The client experiences goodwill when he sees evidence that he matters and that his needs are met consistently over time.

Professional Competency: Goodwill isn't enough; an advisor must also be skillful. This means that the FA responds rapidly and warmly, reveals her knowledge, and proactively advises clients about hidden dangers and possibilities.

Time: All of these elements must be present over time to inspire deep and abiding levels of trust. Experienced advisors acknowledge that clients who have worked with them for at least five years tend to maintain more tenacious levels of trust than newer clients.

A Closer Look at Experiences

With this deeper understanding of the trust equation in mind, we can now look more closely at how experiences build, support or destroy trust.

The first point to understand is that an experience can cause one of two different *emotional* reactions: positive or negative. Neutral events do not register in the conscious mind and therefore don't cause an emotional reaction. However, any amount of positive or negative emotion causes an experience to be consciously recalled. In this way, the experience the client has with his advisor will either build up or break down the trust in a relationship.

The second point is that an experience can be either *expected* or *unexpected*. The human brain functions very much as a prediction mechanism. It uses information gathered through many experiences to anticipate what is likely to happen next. This is critical to survival, so human beings often try to predict the future.

Painful surprises and unexpected experiences are quite disturbing for most people. Our brains consistently work to anticipate future events so that we can be prepared to handle challenges or respond to opportunities. When our expectations are not met, we can feel strongly that something's gone wrong with our normal ability to cope with the world.

Recognizing that experiences can be either positive or negative and that those experiences can be either expected or unexpected is the basis to understanding the four types of experiences that clients can have:

- **Type I:** A *positive* experience that was *expected* by the client. This type builds trust over time. Obviously, the FA wants to create consistently positive experiences for her client.
- **Type II:** A *positive* experience that was *unexpected* by the client. This is a pleasant surprise that builds trust even though the advisor may not be responsible.

- **Type III:** A *negative* experience that was *expected*—one that confirms an advisor's prediction. This type typically supports trust even though the information may lead to negative feelings. This allows an advisor to give guidance that may seem painful to the client, such as increasing a savings rate or taking greater risk in a portfolio. But if the experience was expected, most clients see the advisor's effort in a positive light, which supports trust.
- **Type IV:** A *negative* experience that was *unexpected*—a painful surprise. The brain is shocked when the anticipated future does not arrive. Consider the client whose portfolio performed well for a few years and who extrapolates that this performance will continue, but it doesn't. Perhaps a client discovers that his FA neglected to advise him on some aspect of his financial plan and there is a negative experience because of the oversight. In both cases, the unexpected negative can shatter trust.

The Seven Inevitable Questions That Clients Ask Their Advisor

More than three decades of observing the dynamic relationship between clients and their advisors have revealed a set of questions that clients have for their advisor. While the client may never ask any of these questions out loud, they represent fundamental curiosities about the nature of the advisor-client relationship. They are ways in which the brain seeks to gather information so it can predict future outcomes.

The questions are organized into two groups. The first group relates to whether or not the client can expect consistent goodwill from his advisor. The client wants to know:

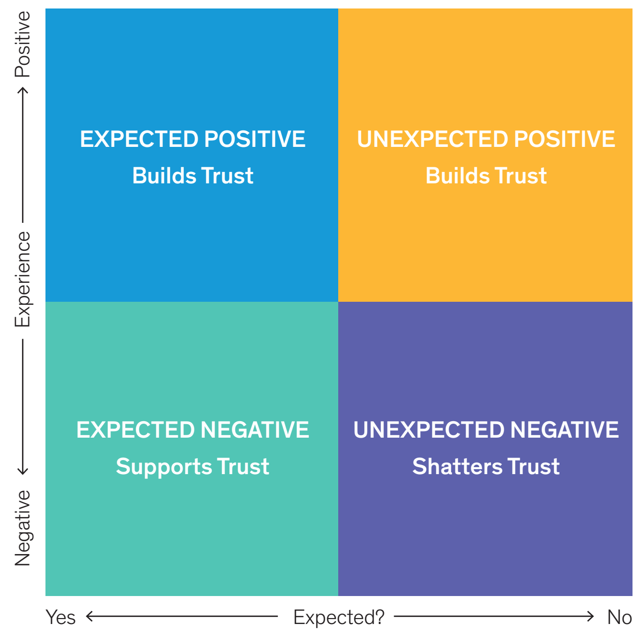
1. Do I matter to you?
2. Do you *get* me?

The client observes the advisor's behavior and builds a set of expectations based on what he has experienced. This is how he determines if the advisor is trustworthy and if he is safe with that advisor.

The second group concerns the advisor's professional skills and whether the client can anticipate good results for the fee paid:

3. Do you know more than I do?
4. Are you great at what you do?
5. Do you see what I see?
6. Am I getting a good deal?
7. Do I have reason to believe that the future I want is the future I will get?

FOUR TYPES OF EXPERIENCES



Number 7 is the most important because it relates to the ultimate prediction that the client wants to come true.

Knowing what is deep in the client's mind allows the prudent FA to create experiences that show the client:

1. You matter to me. You are a real person in my life.
2. I get how you feel. I know what you are concerned about.
3. I see the bigger picture. I can explain it to you.
4. I know what to do.
5. I understand the current situation. I know the implications.
6. Here's what I recommend we do. And here's how my recommendation is different than that of other advisors.
7. I am confident that I can help you achieve your desired outcomes if you take particular actions.

By providing multiple experiences that deliver these kinds of information, the advisor creates positive future expectations for the relationship, and trust will grow stronger.

EXPERIENCES IN LIGHT OF THE SEVEN QUESTIONS

Experiences in Light of the Seven Questions

We can organize the seven questions via the set of experiences that we explored earlier. This helps the brain accumulate information so that it can attempt to predict the future. The more the client experiences his advisor being consistent and positive, the stronger the trust will grow.

Questions 1 and 2 (Type I) create positive expected experiences and build trust. Obviously, if the client ever experiences that he doesn't matter, the relationship will be shattered.

Questions 3, 4 and 7 (Type II) build trust by using the power of positive surprises. The advisor provides experiences that were unexpected, which reveal that she knows more than the client about investments and wealth management. She solves problems that the client didn't even know he had. These positive experiences, though unexpected, build trust.

Questions 5 and 6 (Type III) can be negative but at least are expected. Not every part of a relationship is pleasurable, but unpleasant interactions can be meaningful. For example, answering "Am I getting a good deal?" can be a positive experience because it gives the FA an opportunity to showcase her standard of care. Or if the client sees alarming circumstances, the advisor can confirm that she sees them and knows what to do. These experiences support trust.

Most important, the advisor needs to avoid Type IV experiences—the client having an unexpected negative experience. If the client doesn't achieve his expectations for the future or discovers that something important was missed in his financial plan, the relationship can shatter.

So What?
What Are the Implications of the Current Situation?

Now that we have analyzed the details that define the current situation, let's look at how the combination of client expectations and market dynamics in a maturing market can lead to a perfect storm and potentially put client relationships at risk.

Headwinds in a Maturing Market

All FAs have times when, despite all their tools and expertise, external limiting factors impact their decision-making. These include:

The Problem of Uncertainty: Capital markets are incredibly complicated. This means that cause-and-effect relationships are impossible to thoroughly analyze and understand. Therefore, any investment decision represents a fundamentally uncertain future outcome.

The Problem of Complexity: There are an almost limitless number of possible investment options. There aren't enough hours in a week to analyze all possible variables, and those variables change constantly.

The Problem of Urgency: There can be a cost to delaying making an investment. This further complicates the problems of uncertainty and complexity.

These fundamental limiting factors are present in every stage of the market cycle. This means that the capital markets can always generate an unexpected negative experience. As we've discussed, the consequences of unpleasant surprises can be dire.

The dynamics of today's market include the likelihood of greater volatility, the pandemic, supply chain issues, the potential for monetary policy errors and heightened inflation. While these factors don't guarantee that investors will have negative experiences, the prudent advisor works hard to prepare clients for a maturing market.

Recent Trends Indicate a Period of Increased Volatility

The vast array of issues makes it hard to see the future clearly. But when we use history as a guide, we see that in the past, specific forces contributed to increased volatility. While only time will tell whether we are entering a volatile period, numerous research reports from industry sources show additional concerns about lower growth, reduced labor and price pressures.

The levels of complexity and uncertainty in today's markets show that prudent FAs should expect an increased chance of clients experiencing unexpected negative surprises. Given the impact this can have on the advisor-client relationship, it is time to be thoughtful about relationship management. Rather than enjoying complacent confidence that markets will continue to provide positive experiences, a heightened level of caution seems clearly warranted.

Predictable Patterns of Behavior

In mature markets, the prudent FA should also expect clients to exhibit the built-in behavioral-finance vulnerabilities that are present in all of us. These powerful shortcuts, known as heuristics, are more likely to be activated in today's market because years of strong returns have established a positive expectation for future investments. As we discussed earlier, not all expectations are rooted in reality. Here are several heuristics that the prudent advisor should be prepared to encounter:

- **Inappropriate Extrapolation:** This heuristic is the tendency to predict the future based on the past and to see patterns continuing. Although the human brain's natural tendency is to expect a continuing pattern, markets operate quite differently. Observations have revealed that markets typically move up and down around a mean and have an average pace of growth. This goes against everything that our brain has learned over the past 50,000 years.

  The prepared FA doesn't allow investors to be seduced by built-in heuristics. She teaches them that past patterns don't always predict the future.

- **Confirmation Bias:** This is when a client searches for confirmation of a decision that he already made and feels comfortable with while ignoring evidence that there may be a better option. Searching for alternatives and questioning familiar, comfortable choices can be painful and time-consuming. This heuristic protects the decision-maker from that pain and effort.

  In a maturing market, confirmation bias will cause the investor to look for evidence that future market returns are likely to continue the benign patterns of the past. If markets continue to exhibit a positive pattern, the searching can become its own vicious cycle. From a rational, long-term perspective, it is clear that markets fluctuate unpredictably and that the longer a positive pattern exists, the more likely it is that a negative correction will occur. But some clients don't act rationally. They use confirmation bias to find comforting evidence that things are likely to continue in a positive direction.

  In a maturing market, the savvy FA protects her client from confirmation bias so that he doesn't get surprised by a negative event.

- **Loss Aversion:** Pain is the primary motivator of human behavior. Research has revealed that the pain of loss is several times greater than the experience of pleasure from a gain. Investors who use this heuristic seek to take action to avoid that pain by pulling their capital out of the market. This action typically happens well after the markets have corrected, effectively locking in the loss.

  As the markets recover, it takes time for the investor to regain his confidence that the markets won't hurt him. He remains on the sideline until he realizes that he is missing out on the new set of gains. By the time he is ready to redeploy his assets, the markets have largely recovered and he has missed an opportunity. This becomes a vicious cycle of reactivity and loss.

  The proactive FA not only protects clients from losses; she tries to prevent clients from experiencing negative surprises and losing confidence and trust.

- **Social Proof:** Observations of market dynamics show a significant amount of "herd behavior" around investment decision-making. Social proof is a heuristic by which a client uses other people's choices to confirm his own. But successful investors know that investing requires the opposite thinking pattern: if everyone else is crowding into a stock or sector and driving the price higher, it's already too late to capitalize on the opportunity.

  In our interconnected world, clients are surrounded by other voices, both personal and in the media, that are informed by the same behavioral-finance vulnerabilities. This creates a vicious cycle where an individual's thinking is influenced and confirmed by the patterns that surround him.

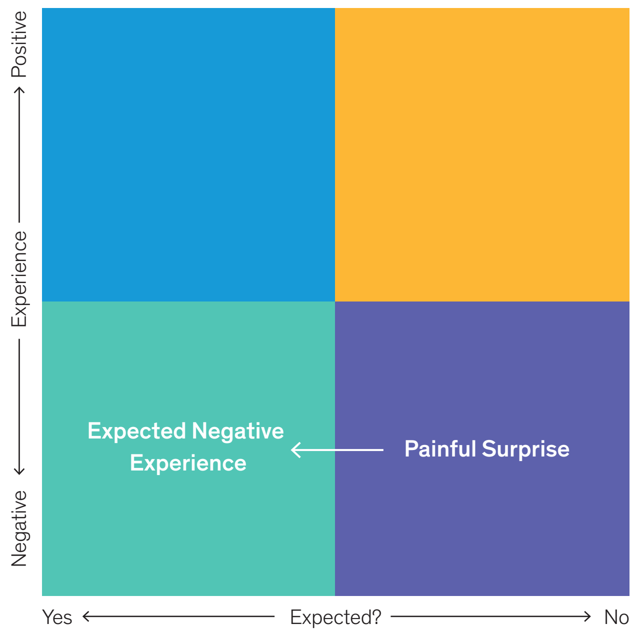
  The experienced advisor serves as a firm and clear voice of reason, making it easier for a client to think his way out of the behavioral-finance trap.

- **Narrow Framing:** This is the most basic heuristic. It reflects the brain's need to limit the constant stream of available information. Think of narrow framing as the inclination to zoom in and focus on one piece of data and block out all others. This protects the brain from becoming overwhelmed. If an investor simplifies the problem of selecting an investment by choosing one that's familiar and therefore emotionally comfortable, he's using narrow framing to keep alternatives out of consideration by hiding them.

  As a primitive survival tool, narrow framing worked great: if a person were attacked by a wolf, he would have to focus intensely and narrowly to survive. Unfortunately, as a tool for coping with complexity in modern life, narrow framing is a disaster.

  The savvy advisor helps clients fight their built-in tendency to focus intensely on perceived threats. Instead, she offers ways to see a wider framework for thinking and problem solving.

SHIFT FROM UNEXPECTED TO EXPECTED NEGATIVE EXPERIENCES



Heuristics in Maturing Markets

These predictable heuristics represent an enormous risk to the advisor-client relationship in three ways:

- They set up unreasonable expectations. The past few years of benign or positive markets have left clients unprepared for what may come next. If an advisor doesn't prepare her clients, she increases the likelihood of any experience being an unpleasant surprise.
- They cause the majority of investors to ignore the potential for negative events and greater volatility and to maintain the illusion that markets will be as buoyant in the future.
- When combined, narrow framing and confirmation bias further intensify the client's irrational perspective.

The Potential for Unexpected Negative Experiences Is High

The big "So what?" of our analysis is that the external environment of our current maturing markets combines with the inevitable nonrational expectations of the typical investor to create a perfect storm of relationship risk.

It's important to recognize that FAs can be influenced by the same heuristics as their clients. Many advisors find it uncomfortable and inconvenient to believe that client relationships need to be managed more intentionally. Nevertheless, by looking critically at the potential negative impact of today's markets, the prudent advisor can more accurately assess the risk to her business.

With that risk clearly in mind, we can now turn our attention to strategies that are based on behavioral finance and designed to help preserve the advisor-client relationship and build trust.

Now What?
Four Behavioral-Finance Strategies for Navigating a Maturing Market

At this point, we have used our critical reflection model to describe the important client relationship-management issues that set the basic context for the work of an FA (i.e., "What?") and looked at the implications of this in the current situation (i.e., "So what?"). We can now consider how to respond to the situation and the potential consequences for managing client relationships. It's time for us to ask: "Now what?"

Proactive Versus Reactive: Overcome the "Vaccine Effect"

More than 30 years of observing human behavior in the financial-services industry show a pattern. When given a choice, most people wait to solve a problem after it's happened instead of avoiding a problem before it occurs. Given the events surrounding the COVID-19 pandemic, we call this the "vaccine effect."

While many people quickly took advantage of vaccines, others waited or refused to be inoculated. Interestingly, observations revealed that once they were hospitalized, many unvaccinated patients requested the vaccines; experiencing the problem motivated them to take action to solve it. Unfortunately, with the novel coronavirus, it was too late. They were already sick.

This provides a meaningful illustration for advisors who are navigating a maturing market. It is uncomfortable to proactively speak to clients about heightened volatility and to suggest new risk-management strategies. Many FAs prefer to wait until there is an actual problem before they address their clients. Unfortunately, in the same way the vaccine is not effective after someone is sick, once a client has had an unexpected negative experience, the emotion he feels has already undermined his trust in his advisor.

Given the high cost associated with unexpected negative events, the first fundamental strategy we recommend for FAs in a maturing market is to proactively address the potential for greater volatility. This way, the future event, while still negative, is expected rather than a painful surprise.

Understand the Fight-or-Flight Instinct

As we've discussed, pain is the primary motivator of human behavior, and when it comes to investing, loss aversion is one of the most important heuristics for an advisor to be aware of. You now know that the brain is primarily a survival machine designed to gather information and predict future events so that we can navigate uncertain times. For most of history, navigating challenges in the environment was a life-or-death proposition. As a result, the human brain has a hair-trigger reaction to unexpected negative events.

Understanding this triggering mechanism is the goal of behavioral-finance research. The results of that research provide us with some practical guidance for how to help clients make higher-quality decisions and avoid built-in vulnerabilities.

When people have an unexpected negative experience, their first instinct is to assume that there is an implicit danger associated with the surprise. Human survival is based on the brain's ability to assume that unexpected negative events are potentially life-threatening.

Even though negative investment results are not necessarily life-threatening in the traditional sense, they register as highly painful and ominous to the majority of investors. The prudent advisor understands and accepts that this reaction to an unexpected negative event is predictable.

When this perception of danger is fully triggered, the brain activates a physiological response known as the fight-or-flight instinct. Outside any rational control, the body becomes prepared to either attack or run away. Either way, the brain assumes that some kind of physical action is necessary and stimulates a number of biological processes that cause the person to feel an overwhelming, irrational need to take action. Then, the brain searches for the best action possible.

In the world of investing, the action the brain suggests is to move money out of the "dangerous" market. Such a decision feels not only absolutely logical but completely necessary once the fight-or-flight instinct is activated. Experienced advisors who have had many conversations with clients know how difficult it is to keep them from taking this kind of action.

As we have discussed, pulling money out in a down market makes matters worse, and the unexpected negative experience tends to undermine or even shatter a client's trust in his advisor. This makes it even harder for the advisor to work effectively on behalf of the client. Importantly, once this cycle is initiated, it is very difficult to interrupt it.

With this in mind, the second strategy prevents that cycle from starting. This is far more effective than interrupting it once it begins. As we discussed earlier, educating the client before he gets activated means that the advisor can intentionally shift the unexpected negative event to an expected event that doesn't surprise the client.

In maturing markets, in addition to speaking about the past, it is necessary to provide some perspective on events that are likely to happen soon. This does not mean trying to call the market; rather, it means educating clients about the conditions of a maturing market and what those conditions can potentially bring.

A more advanced version of this strategy is for the advisor to suggest actions that the client can proactively take to avoid exposure to future volatility. By combining an action with the introduction of a possible positive outcome, the advisor effectively "vaccinates" the client against both the pain and an inappropriate reaction to an unexpected negative experience.

Empathy: Shift from Investment Process to Desired Future Outcomes

The third strategy an advisor can use is to shift the context of the conversation from short-term market dynamics and investment results to the specific, long-term desired outcomes that inform the client's financial plan.

If a conversation between an advisor and her client is primarily about market dynamics, then most likely the client and advisor will spend a lot of time processing the emotions associated with market volatility. Even when markets are benign, there are periods of volatility. Each rise or fall represents the potential for an unexpected negative experience.

However, if the advisor and the client agree that the FA's role is to use the capital markets to achieve long-term financial goals, short-term market events are overshadowed by the greater significance of ongoing progress toward those goals. This allows the advisor to talk about the likelihood that the client will achieve his desired outcomes despite current or future market volatility.

Of course, this requires the FA to focus on the client's financial goals and the role of the financial plan as organizing principles rather than zoom in on the mechanisms of the capital markets. In maturing markets, this perspective on the advisor's role and on what is important to the client serves to protect the working relationship, and almost any conversation between an FA and her client can build or support trust.

Shift from Unexpected to Expected Experiences

Even with clearly defined financial goals, unexpected negative events can trigger very strong reactions. The prudent advisor who wants to preserve the working relationship with her client will take action designed to shift the client's experience of market volatility from *unexpected* negative to *expected* negative events. As we have seen, it is the impact of a surprise that causes the client to lose trust in his advisor. If the FA makes a prediction that comes true, the negative event can confirm the advisor's professional skill. This is why we say that *expected negative experiences can support trust*. For some advisors, this sounds counterintuitive; they only want to talk optimistically about the future. But remember that unexpected negative events put the relationship at risk.

With this in mind during maturing markets, the fourth strategy is for the FA to share her perspective on the capital markets and to intentionally introduce the potential for negative future outcomes. We recommend the following seven-step story structure, based on the critical reflection approach, as a way to organize your capital-markets perspective:

1. **What is the current situation in the markets?** The story starts with several observations of the current market conditions. This creates a shared agreement about the issues that exist. It's helpful for the FA to look at materials provided by her firm, the media and select asset-management partners to choose the right themes to describe the current situation.

2. **What are the important mechanisms? How did we get here?** Next, the advisor should reveal and explain the cause-and-effect mechanisms that led to the current situation. This shows the client that the FA has a deep understanding of the markets and that she is paying attention.
3. **Does history offer any perspective?** When it comes to investing, most clients don't have much information about the past. Discussing historical trends allows the FA to provide a richer framework of information and patterns that will inform the future. A longer perspective also establishes the FA as a capable professional with a greater database of knowledge than the client.
4. **Have there been any attempts to address the implications?** Various institutions (like the US Federal Reserve) may have implemented strategies designed to affect the market's trajectory. There may also be reactions within various subsets of the markets that will impact outcomes. These forces are worth noting, especially if they inform the strategy that the FA uses to navigate current market conditions.
5. **Based on these dynamics, what are the potential consequences?** This is the paramount question. While it is impossible to thoroughly explain what has happened or accurately predict exactly what will happen, some parts of the markets are understandable and allow for a rough approximation of future outcomes. The FA can make general observations of how the market is likely to behave and provide enough information upon which to decide on a course of action.
6. **With this in mind, what are we recommending?** Depending on the current situation, there may be dangers or opportunities ahead that require appropriate action. This step will be determined by what the advisor anticipates will happen next and the best course of action for the client to take. Those actions may be protective or opportunistic depending on the anticipated trajectory.
7. **If we take these actions, what are the short-term risks and long-term benefits?** This final step closes the story, confirms the FA's professional knowledge, reassures the client that the situation is being managed wisely and lets him know that he can have confidence in the future.

If the FA's investment strategy already considers general market dynamics, no other action will be necessary. In these cases, the story reassures clients that, despite the events, the investment process is sound and they can have confidence that the future they want is likely to be the future that they will get. In other cases, the FA wants the client to agree with the strategy she is planning to use. In these instances, the purpose of the story is to break through the heuristics that may be informing the client's thinking and offer a rational assessment of the current situation and the need to make a change in how capital is deployed. In this way, the seven-step model reflects the same structure as the critical reflection model: we start with a hard, rational look at the current situation and then explore the consequences. Given that there is much at stake and that the relationship between the client and his advisor itself can potentially be harmed, getting clear about the implications of the situation and then determining a set of actions that will protect the investor and the relationship are critical when markets are likely to be more volatile.

Conclusion

As the ancient Greeks said, we cannot step into the same river twice. As time passes, things change. But few things change more frequently and more dramatically than the capital markets. In today's maturing market, there are powerful forces coalescing that suggest investors will experience greater volatility in the not-too-distant future.

Rather than trying to predict the market, prudent advisors can apply an understanding of both market *and* human dynamics and take strategic actions to protect the relationships they have with their clients. At the very least, this is a time for advisors to be proactive in conversations with clients and to demonstrate goodwill and professional competency as often as possible.

Ideally, this is a time to educate clients about the potential for unexpected negative events in the marketplace and about patterns that may not have occurred for several years. This is also a time to educate clients about the power their own decision-making vulnerabilities have to cloud their judgment. Spending a few minutes on these concepts regularly when doing check-in calls and even more quality time when conducting client reviews will pay off in tremendous benefits and a high quality of trust that clients have in their advisor.

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