WORKING WITH THE EMOTIONAL INVESTOR

Financial Psychology for Wealth Managers

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Foreword by Bill Griffeth

PRAEGER™

An Imprint of ABC-CLIO, LLC
Santa Barbara, California • Denver, Colorado

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Preface

You inherit your identity, your history, like a birthmark that you can't wash off.
—*Hugo Hamilton,* The Sailor in the Wardrobe

My late father, an investment advisor like myself, was a cold, distant, and emotionally unavailable man. Though I suspected as a youngster that he loved me, he seldom displayed any affection or warmth, even as I longed, as many young boys do as they are growing up and exploring and discovering their emerging male identities, for a close connection with my father.

Instead, my father prided himself on his logic, intellect, and discipline. Emotionally fastidious, he walled himself off from feelings, and disparaged their display in others. "You have hurty feelings," he once told me when I was a young boy, his words stinging me like garden nettles and making the young male psyche that was taking shape in me at that tender age feel an awkward mix of shame, embarrassment, and astonishment. How could someone who allegedly loved me talk to me that way? At the time I felt diminished, insignificant. Even foolish. Most of all, I felt *disconnected* from him. Didn't he know how much I longed for a close relationship with him as my father?

He never knew how much his words hurt me, although, on his death bed, he whispered to me, "Suffering, suffering."

Make no mistake. I grew up a child of privilege. My father and grandfather were descended from a long line of New York bankers, brokers, entrepreneurs, and financiers going back to the early 1800s. Their flinty resolve, steely discipline, and emotional reserve served them well in business in the early years of our country. I can remember, for example, my father telling me stories of how ancestors of mine from the Revolutionary War onward had been in the fur industry, based in Danbury, Connecticut. Beginning in the 1830s, my great-great grandfather began to crisscross multiple states, extending west to St. Louis by stage coach, steamer, rail, and foot, collecting on accounts and looking for new sources of high-quality animal pelts when his sources in New York and New England dwindled. It was a time when the U.S. banking system didn't exist as it does today, and he became a wary trader in local bank paper, avoiding notes issued by some banks while accepting bank paper from others. He thus became an arbitrageur of local bank paper across much of modern-day Virginia, Kentucky, Ohio, Indiana, and Illinois.[1] Later, he and other descendants set up a family bank that served still other states and did business overseas. All this set the stage for later descendants, my great uncles and paternal grandfather, to found and manage a Wall Street brokerage firm at the turn of the 20th century.

My family's business acumen over multiple generations blessed us with material abundance. As a child, I grew up with servants on a 75-acre parcel of land that had been a farm in New Canaan, Connecticut. My parents built a house there soon after World War II. It was a beautiful, formal home with nine bedrooms and eight and a half bathrooms. The rear part of the house was where the servants lived: a cook and butler, a chamber maid, and the governess. Dinner was served to us each night by our butler, William, who dressed in a bow tie and jacket. As one of five boys, I grew up spending my falls, winters, and springs running across hills, playing games in the forest and on the lawns, and fording streams. Summers were spent on the pristine beaches of Cape Cod, where my father indulged his passion for sailing, a passion I too embraced from the age of 4. It is one of the few pleasant memories that connects me with my father to this day.

Yes, growing up we were materially very comfortable. But in our household, emotional distance was the norm. Both of my parents were cold and aloof, which is why, at an early age, I formed a close attachment to a woman named Bibi, who was my governess. I absolutely adored Bibi, but when I was about eight years old my parents decided that Bibi and I had grown too close for my own good. Without any warning they fired her, unbeknownst to me.

I remember the day clearly even now.

Bibi had Thursdays off, and I typically came to her room Friday mornings to say hello. On one particular Friday morning in 1959, I remember my mother coming down the hallway of our house, her crisp, pressed cotton dress rustling as she walked. She came upon me as I waited to see Bibi and told me Bibi had been dismissed. I would never see her again. I was crushed! I'd grown so attached to Bibi, closer to her, in fact, than to my own mother, which she must have realized. So, she and my father had decided Bibi needed to be erased from my life forever.

"You'll never see her again!"

As my mother's harsh words echoed in my innocent, eight-year-old ears, time seemed to stop.

To this day, I still remember standing and staring at the plain, white door that led to the servant's quarters from our house, through which I always walked to connect with Bibi on Fridays. But now I felt unable to open it. In fact, what seemed to loom before me was not a door but an enormous chasm. I felt myself teetering, as if on the edge of a cliff, about to fall over.

Recalling that moment today, nearly 60 years later, I believe I was experiencing the first moments of grief, my mind racing as my eight-year-old psyche struggled to make meaning of what had just happened to me.

I'll never forget the images of that day. On that day, in that hallway, brute reality intruded into my idyllic childhood existence, and swept away someone very dear to me. In some respects, you could liken my feelings that day to the emotions that victims of hurricanes and tornadoes feel when they experience their worlds ripped quickly asunder—without warning or explanation. On that day, I felt the emotional umbilical cord of my life was cut. The moment proved to be a traumatic loss of innocence for me that led to several years of debilitating depression. Depression that was only gradually relieved by therapy, tears, and time.

A few years later, when I was 16, I was in the library of our home when our maid, Jenny, brought someone by to see me. Jenny told me it was somebody I'd known many years before. But when I met the surprise visitor I didn't recognize her. Only later did I learn that it was Bibi. After I failed to recognize her, I'm told that Bibi left our house, never to return. I also learned that when she left my parents' employ, she gave up working as a governess. That day, my non-recognition of her in the library must have left her as heartbroken as her departure many years before had left me.

Bibi's abrupt exit from my life proved, in retrospect, to be a foundational life story for me. This early and painful loss of "perfect love" affirmed in my young psyche the importance of relationships, stability, stewardship, love, and connection with others, and helped forge the "emotional template" that is the basis of the person I am today.

Bibi had abruptly left my life, but thankfully there was another person in my household with whom I could emotionally connect as a young person. William, our butler, perhaps intuitively stepped in and filled the void, becoming a surrogate father to me in the years that followed. He was *so* different from my father. My father had a dark side, a temper that could become volcanic, which on occasion was directed at me and my four brothers in the form of cold lectures, threats, and humiliating and shaming putdowns. At times he even whipped the family dog. For all these reasons, and the fact that he was seldom around, I never connected with him emotionally.

In contrast, William had a kind and steady way about him and was emotionally present to me in ways that reverberate to this day. It was not unusual for my parents to be gone during the day from our Connecticut house and for William and Jenny to be left to care for me and my brothers. In such instances I got to observe William up close and liked what I saw. William was, as they say, “a man’s man.” More hands-on than cerebral, he knew how to do *everything*. He knew how machines worked and how to fix things. He knew how to dress a turkey at Thanksgiving, as well as the fowl my parents brought home from their hunting trips in New York State. He knew how to get a carpet to lie flat. He even knew how to drive a car up a hill in deep snow without getting stuck. One year, he managed to retrieve our family car from a snow bank in our driveway, after my father ditched it there at the height of a blizzard.

Truth be told, I worshipped William as a boy, and secretly wished he was my father, just as I wished that Bibi was my mother. He held me in his thrall, and filled a tremendous emotional void. Always there, taking care of things. Taking care of me! He seemed the embodiment of responsible stewardship. His presence (like Bibi’s earlier in my life) made me realize how important connections with other people were to me, and explains why stewardship (the “looking after of things”) is a key theme of the work I do today as a wealth advisor.

At 14, I left home and went to Milton Academy, a boarding school just south of Boston. My first year there was difficult for me academically. I was at sea, and it was only through tutoring and generous teachers that I managed to pull myself up. I started at the bottom of my class but graduated in the top third! My Milton housemaster had a lot to do with this. He nurtured me and encouraged me, coordinating my efforts with my parents’ concerns and love. In tenth grade, he introduced me to Quakerism. Its subsequent influence on my life, and his abiding care of me throughout my teenage years, further cemented my attraction to stewardship and helped to create a “protector” personality in me, whose traits I bring to my work with clients today.

Because of my unique upbringing with surrogate-like parents and my early childhood loss of “perfect love,” I grew up with a deep longing for connection with others, and an intense desire to understand human emotions—both mine and others’. These interests led me to choose social psychology as my major in college, because I was fascinated with the nature of interaction between people (no doubt an outgrowth of what I had observed in my own family system growing up). I was looking for clues to understand my parents’ emotional remoteness, my desires for closeness and connection with them and others, and the strong emotional pull I felt toward

Bibi and William as a youngster. Social psychology thus seemed like a perfect course of study. As a discipline, it sought to unpack and explain the emotional dynamics that exist between individuals and groups. And, it put a high value on human emotions and motivations as keys to understanding human behavior and actions.

Eventually, however, my interest in social psychology waned. It became too academic for me. I sought more "juice." So, I migrated to theater and drama, where I pictured myself exploring the world of human emotions and motivations in greater depth, and doing it on stage! Looking back on it now, I clearly was in search of an understanding of my emotional self, willing to try on roles crafted by playwrights to see if any resonated as being me. But in my school's theatre department I encountered more adolescent egos than insights into the nature of human nature. So, after a momentary stab at acting and writing plays, I moved on again, still searching.

It was then that I discovered geology. Geology had an absence of human actors (and egos), so it was refreshing! There was plenty of drama though. Think Continental Drift, glacial flows, lunar landings and moon rocks! Talk about theater! The physical world provides a dramatic stage for a geologist, and something in this world and work resonated in me at the deepest levels of my being.

At a deeper, emotional level, geology is about stewardship of physical assets (land); about conservation; about careful observation and data-gathering of what's in front of you, and about developing a careful frame of reference that respects not only what you observe on the surface of things but also what lies beneath. As a science it appealed to my analytical side in a very robust way. Geology also gave me the opportunity to work closely with private clients to help them with the stewardship of their land, to understand their needs and desires, and to act as a consultant in helping them achieve long-term goals from their (physical) assets. Thus, it appealed to the stewardship and servant sides of my personality.

I worked happily in the field of geology for ten years, but though I loved the work the pay wasn't good, and I started to wonder how I was going to send my three sons to college. Moreover, I was looking for deeper, more substantive ways to be of service to others and to form long-term relationships with people. Working as a contract geologist generally meant consulting relationships of limited duration, after which I'd move on without further contact with a client.

For all these reasons, I began considering what else I could do with my life other than be a geologist. It was about this time that my interest in social psychology reasserted itself, along with what had been a long-time fascination with financial markets. As a wealth advisor himself, my father had always dissuaded my brothers and me from careers on Wall Street. He called it "dirty work." But somehow I found the machinations and gyrations of the financial markets fascinating nonetheless. Moreover, investing was an activity that involved disciplined thinking (as geology does) and that encompassed the full suite of interests I had in social psychology, behavioral finance, and stewardship. The idea of being able to build long-term relationships with clients whose money I would manage was like icing on the cake!

My move over 25 years ago from a career in geology to one in business and finance was one of the best decisions I've ever made. For more than a quarter century, I've had some wonderful mentors who helped me chart a course first to business school (Columbia) and then to jobs at CIGNA; Shawmut Bank in Hartford, Connecticut; Boston Private Bank and Trust; Fiduciary Trust; and several other companies. Today, I am a senior portfolio manager at Hemenway Trust Company.

Human emotions and their role in driving investor behavior have continued to fascinate me since the day I entered the wealth advisory business. Rewardingly, I've built my entire career as a wealth advisor around understanding the role that emotions and human psychology play in investor behavior, both in low-stakes and high-stakes situations.

As wealth advisors, we must pay attention to the rich human dramas that reside in our clients and understand the experiences, stories, hurts, fears, and moments of love and triumph that make them the unique individuals they are as adults.

Don't be afraid to discover this treasured material! Taking the time to unearth these dynamics is essential to helping us better serve our clients and continually deepen our knowledge and appreciation of human emotions as a wellspring of people's motivations and actions.

Working with the Emotional Investor is intended to provide you with tools and insights I've gathered from a 25-year career in the wealth advisory business. It's my hope that this book will enhance your own approach to working with clients, helping you to understand the unique dynamics of human nature and how these factors inevitably influence peoples' thinking and decision-making about investment planning and wealth management.

Chris White
Pocasset, MA
Summer 2015

Introduction

As an investment advisor, how much time do you take to truly get to know your clients as *people*?

I've been working as an investment analyst, portfolio manager, investment coach, and wealth management advisor now for over 25 years, and if there's one vital lesson I've learned over time it's that people—*individuals*, *couples*, and *families*—are both complicated and conflicted when it comes to issues of money, retirement, wealth management, and investment planning.

There are many reasons for this.

First, I believe that people's views about money (and security) can usually be traced back to early life experiences of pain and loss associated with family, friends, relationships, and love. These formative experiences deeply influence the development of a person's "emotional template" and shape how they think about their assets, risk-taking, and their ability (or inability) to control people and events later in life. For example, the person who experiences significant personal or emotional loss early in life may, later in life, display little trust in others, a high need for security and control, and/or little tolerance for risk-taking when it comes to making investment decisions. I've often seen such dynamics at play when I work with certain clients or meet new client prospects for the first time.

Second, peoples' attitudes about money can be profoundly shaped by what their parents, grandparents, or other authority figures told them about it when they were growing up. Was your client encouraged, from an early age, to be frugal and save for a rainy day? Or, did he or she grow up as the product of profligate parents? People often carry such "messages" about money with them into their adult lives.

Third, some people's attitudes and feelings about money are shaped based on whether they grew up with wealth or achieved it for themselves. Hence, the popular, if somewhat simplistic image of wealth creators as world-class penny-pinchers, and wealth inheritors as world-class spendthrifts.

Still other people's views about money are influenced by family dynamics, personal beliefs, college professors, religious faith, and philosophical convictions. Who made the greatest impression on your client as a child or young adult?

Finally, people's attitudes about money (and risk-taking) are frequently driven by primal emotions like fear, greed, guilt, discomfort, even a sense of inadequacy. Such emotions can literally sweep over them, immobilizing them from making clear and rational choices or acting in their best interests at critical times.

People Are Complicated!

Yes, when it comes to money, people are complicated! Thus, it's vital that we, as wealth advisors, understand our clients—be they individuals, couples, or families—as emotional and psychological "systems." These systems are characterized by various dynamics which manifest themselves in specific behaviors and attitudes we can observe. It may require considerable time, experience, sensitivity, and maturity on our parts to understand and appreciate our clients in this light. However, only by understanding our clients as unique human systems can we hope to effectively advise them about their wealth management plans and priorities.

But wait, there's more!

We, as wealth advisors, are complicated "systems" too. We too are shaped in our attitudes about money based on our life experience and internalized "scripts." We see the world through our own set of filters; hence the bromide: "We see the world not as it is but as *we* are." For example, if you, as a wealth advisor, grew up without a lot of money and find yourself counseling somebody who's had it in their family for generations, you may harbor a hidden envy or even resentment about that client that can color your advice. Conversely, if you grew up with wealth as the son or daughter of a wealth creator, you may or may not (based on the parenting you received) have a deep appreciation and understanding of the first generation wealth creator you are now advising.

Understanding ourselves as systems (with our own inclinations, biases, subconscious beliefs, assumptions, aversions, and attractions) is thus just as important to our success as wealth management advisors as understanding the psyches (emotions, needs, fears, concerns, hopes, etc.) of our clients.

Finally, the stock market in which we operate as advisors is a system as well. Its unpredictability spooks investors, defies carefully designed financial models and elegant predictive reasoning, and leaves the world of investing looking like a crap shoot, a shot in the dark, a roll of the dice—an activity not for the faint of heart!

Why I Wrote This Book

It's because of all the human and emotional variables at play in investment advisor-client relationships that I decided to write *Working with the Emotional Investor: Financial Psychology for Wealth Managers*. For, as the title of this book suggests, a client's investment and wealth-building decisions are invariably colored and driven by a welter of emotional and psychological factors and forces—some of them obvious and clear, others subtle and hidden from easy view. Whether visible or hidden, these emotions and dynamics invariably surface when it comes to discussing matters of risk tolerance with a client, especially in times of marketplace volatility or uncertainty.

In my view, it's our duty as responsible and ethical wealth advisors to educate ourselves about these forces and factors and how they drive all human behavior. It's also incumbent on us to become conscientious students and observers of human nature in general and of our clients in particular. This is essential if we are to advise clients effectively and customize client investment "solutions" based on their personalities and degree of risk tolerance. Wealth advisors who are trained, sophisticated, and astute enough to probe and gain understanding of the emotional make-up of their clients will be able to connect with clients (be they individuals, couples, or families) in ways other advisors cannot. Indeed, they'll be able to co-create investment strategies and plans with their clients that are custom-suited to each client's personality, priorities, goals, and temperament.

By reading *Working with the Emotional Investor* you'll learn the following:

- Why all investing and risk-taking by clients is *emotional*—driven by psychological factors such as early experiences of love and traumatic loss, and by powerful, sometimes very subtle family dynamics that a child experiences early in his or her life.
- Why all clients therefore can be thought of as unique psychological systems with certain observable qualities and traits that an advisor must be sensitive to, in order to fully understand an individual, and to accurately assess that person's risk tolerance when developing investment and wealth management plans.
- Why wealth advisors must understand themselves as human systems as well, because of the ways it impacts their approach to working with clients.
- Why every client, based on their emotional/psychological template, displays a unique personality type in the context of the client-advisor relationship, and why

this type can change based on perceived risk and on factors such as market uncertainty and volatility.

In *Working with the Emotional Investor* you'll also learn to:

- Use my unique client typology to identify different client personalities and then choose the best way to engage a client.
- Employ sophisticated client relationship management practices such as curiosity, appreciative inquiry, powerful questions, and other tools to understand clients' needs and drives at a deep, psychological level.
- Apply my client management approach with equal effectiveness to client engagements involving individuals, couples, and families.

Working with the Emotional Investor is divided into three distinct parts.

In **Part I,** I explain and elaborate on my theory of emotional templating and how it explains a client's appetite for risk and view of the world around them. I share deeply personal experiences of emotional loss from my own childhood as examples to support my thesis that all people are essentially emotional in their responses to the external environment. A person's emotional vulnerabilities become particularly evident in situations of danger or pressure, such as when an investor faces marketplace uncertainty and volatility as they set personal financial goals. Given such realities, I argue that the wealth advisor must develop finely tuned interpersonal skills to flesh out the emotional profiles of their clients and must understand them as fully formed human beings, shaped by their unique experiences.

In **Part II**, I lay out a systematic framework that wealth advisors can use to nurture, manage, and maintain strong relationships with clients. Based on years of working with my own clients, this framework includes a proprietary method for "contracting" with clients early in the client-advisor process; establishing rapport and trust; asking clients powerful questions; setting goals and expectations; defining metrics of success; designing investment approaches that align with the client's goals, values, and priorities; and monitoring and measuring success with financial performance over time. Also in this section, I discuss different types of clients that wealth advisors are likely to encounter in their work, and the importance of advising clients by cultivating a combination of agility, flexibility, creativity and humility. I draw heavily from the theories, ideas, and best practices of social psychology, systems thinking, neuroscience, and emotional intelligence to articulate a highly practical typology of client types that I have developed over the course of my 25-plus years in investments.

Finally, in **Part III**, I speak in depth about stewardship and the principles of servant leadership that I believe are critical for wealth advisors to bring to their work with clients. By adopting the principles of "servanthood" in our work with clients, we can keep our professional egos and agendas in check and ensure that the investment plans we co-create with clients are strongly aligned with their personal values, financial goals, and investment and wealth management priorities.

While much of my client work has been with high net worth individuals and families, this book has relevance and application for any wealth advisor who deals with the assets of others, whether those assets be $100,000, $1,000,000, $1,000,000,000, or even more!

Working with the Emotional Investor articulates a new, radical, yet highly practical approach to building and nurturing client relationships in the wealth management industry today. Some of what I say in this book you may find provocative. I hope you do! I hope also that you will see the relevance of the tools and case studies I present in this book to your own work with clients.

It's my conviction that by reading and reflecting on what is contained on the following pages, it will spark ideas and generate insights that will enrich your own relationships with current and future clients, resulting in "happy returns" for you both!

CHAPTER ONE

Understanding a Person's Emotional Template

Our current understanding of emotion lags far behind our understanding of nearly every other aspect of life. We can chart the universe and split the atom, but we can't seem to understand or manage our natural emotional reactions to provoking situations. We work with nutrition and exercise to increase our energy, but we ignore the richest source of energy we possess—our emotions. We are intellectually brilliant, physically resourceful, spiritually imaginative, but emotionally underdeveloped. This is a shame because emotions contain indispensable vitality that can be channeled toward self-knowledge, interpersonal awareness, and profound healing. Unfortunately we don't treat them as such. Instead, emotions are categorized, celebrated, vilified, repressed, manipulated, humiliated, adored, and ignored. Rarely, if ever are they honored.

—*From* The Language of Emotions *by Karla McLaren (Introduction)*

Emotions. We want to think (and believe) that they play no role, have no place, in the "rationally ordered" world of investing and wealth management. After all, as wealth advisors, we go to business school to study business and economics, not psychology. In our wealth management training we are schooled in the use of algorithms, fancy financial models, economic theory, and predictive reasoning to forecast future return rates. Indeed, one of the essential books in my coursework at Columbia Business School was *The Intelligent Investor* by Benjamin Graham.

But, in fact, much of the motivation for investing is rooted in *emotions*. Ours and those of our clients! It's critical to acknowledge this.

Thus, I've written this book, not to disparage quantitative tools and reason as they apply to investing, but to enlarge and broaden conversations about investing beyond the purely rational.

What exactly is "emotion"? It's hard to define. Remember Supreme Court Justice Potter Stewart's iconic 1964 freedom of speech case, when, referring to pornography, he penned, "I know it when I see it"? The same goes for emotion. Dictionary.com defines emotion as "a natural, instinctive state of mind deriving from one's circumstances, mood, or relationships with others." Further, it continues, it is an "instinctive or intuitive feeling as distinguished from reasoning or knowledge." I would argue vigorously (and will do so throughout this book) that even one's "reasoning" or "knowledge" can be colored by emotions and life experience!

Our Clients Are Psychological Systems Driven by Emotions

In the Introduction to this book, I noted that, as wealth advisors, one of the key principles we have to keep in mind is that every client we deal with is a psychological "system." And a unique one at that. We are composites of our life experiences of love, joy, pain, fear, and loss, ultimately forming the building blocks of our personalities, or what I like to refer to as our "emotional template." This template holds the DNA that explains who we are and why we act as we do. Think of this template as a kind of human software program that provides and sustains the basic functions of our personality. It is, in essence, the system that supports many of our basic and higher functions as human beings and is the source of our behaviors, beliefs, and human motivations.

The Formation of a Person's Emotional Template

As a lifelong student of social psychology and human behavior, I have always been fascinated with how people's emotional templates are formed. Evolutionary biology, of course, plays a huge role. So do the early formative experiences we have that establish the emotional and psychological response patterns that become fully formed in us as adults.

The study of people's emotional natures has been profoundly useful to me in helping me understand how best to work with clients on an individual basis, especially in high-stress or high-stakes situations.

As an advisor, I routinely observe clients and colleagues whose personal and emotional make-up strongly influences both their risk-taking tolerance (high or low) and investment style. In my own case, the loss of my beloved Bibi, whom I mentioned in the Preface, was a painful yet formative experience for me. I transmuted this experience of personal hurt and loss into a determination to protect not only myself but also those around me. Over many years, the concepts of stewardship, compassion, and commitment to others thus emerged and became powerful convictions for me, as I psychologically worked through issues of my own childhood. Today, these principles are among the most important tenets of my philosophy as a wealth advisor.

I am what psychologist David Kantor would call a "Protector" personality, having molded myself, in large part, after William and others whom I mentioned in the Preface. My "Protector" tendencies, which are at the heart of my emotional template today, display themselves daily in my working relationships with clients. Protecting the assets of my clients and being a good steward of people's hard-earned wealth are at the core of my being. This emotional core serves as my emotional, psychological, and ethical guidance system in working with individuals, couples, and families.

Peoples' emotional templates vary, of course, based on their early life experiences. One wealth advisor colleague of mine, "Jake," chooses today to work exclusively in the domain of private equity, with its ten-year holding periods and extended framework for resolving losses and gains from investments. Why does he specialize in this line of work? Jake would argue that having been abandoned by his father at an early age, and having had to deal with the trauma and pain of that experience, his personality is geared toward security, stability, and predictability. Kantor would describe him as a "Survivor" who dealt with his childhood experience of loss by adopting a profession and investment strategy that, as an adult, enable him to safeguard both his financial (and I would argue psychological) safety in anticipation of potential financial losses at a later time.

Another colleague of mine, "Jeremy," whose father was abusive and controlling, is today often personally abusive himself. Financial losses trigger deep despondency and grief in him, reminding him of the ignominy of loss and hurt at the hands of his abusive father. The intensity of Jeremy's emotional pain is only assuaged by the intense relief he experiences from occasionally winning with good stock picks. Not surprisingly, Jeremy likes to invest in value stocks that few others like and finds deep solace from being a loner and outlier. If his stocks eventually wind up doing well, he credits it to his brilliance and insight. If they don't, he has a tendency to beat himself up. He is what Kantor would call a "Fixer" personality.

Finally, still another colleague of mine, "Elizabeth," chose in childhood to react to her father's abandonment by striving to control and exert power over everything she can in life. Today, Elizabeth goes for broke in her investment work as a hedge fund manager. She, too, is what Kantor would call a "Fixer."

In the choices that I, and others, have made as adults, we are all attempting to work through and "work out" the losses of love and expectation we experienced in childhood. In doing so, our identities are shaped, in part, by the emotional bandages we apply to our wounds. Consequently, there's the "Protector," who safeguards the money of others; the private equity manager ("Survivor") who looks for solace and security in long-term investments; the stubborn value manager ("Fixer") who seeks validation of his brilliance and worth as a human being; and the hedge fund manager ("Fixer") who "goes for broke" in the investment decisions she makes for herself and others.

Both clients and advisors thus bring their emotional templates with them to client-advisor interactions. Throughout this book, I'll have a great deal to say about different personality types and how they show up in client-advisor relationships. For now, suffice it to say that understanding the psychology of your clients (and yourself) is key to navigating and negotiating the interpersonal dynamics that are always present in advisory relationships and that come clearly—and critically—to the fore in high-stakes situations.

Harvesting Insights from Psychology and Behavioral Finance

Today, the intersection of emotions, psychology, financial markets, and investing has become a topic of compelling interest to many writers, financial journalists, researchers, and scholars. New insights from behavioral finance, neuroscience, and brain research are helping us to better understand the psychology and biology of financial decision-making as never before, and this has tremendous implications for the work we do as wealth advisors.

Psychologists Daniel Kahneman and Amos Tversky were among the early pioneers and researchers in the areas of psychology, human behavior, and finance. Both men became fascinated with the application of psychological concepts to economics. Classic economics had always held that investors (indeed all consumers) experience financial gains and losses with equal degrees of intensity. In other words, a dollar gained would give the same amount of pleasure to an investor as a dollar lost would cause pain. Kahneman and Tversky doubted this hypothesis. In fact, through their research, first conducted at Hebrew University in Israel in the 1970s, they observed that the amount of pain subjects felt from a loss was TWICE as intense as the amount of pleasure they experienced from a gain. This breakthrough insight came to be known as "loss aversion." Loss aversion argues that a person who loses $100 will suffer twice as much pain from that loss as another person will gain satisfaction from a $100 windfall.

The roots of human loss aversion can be found deep in the forests of our evolutionary past. In such thickets "'sensitivity to losses was probably more [critical] than the appreciation of gains,'" according to Tversky. "'It

AN ILLUSTRATION OF A VALUE FUNCTION BASED ON THE CONCEPTS OF LOSS AVERSION

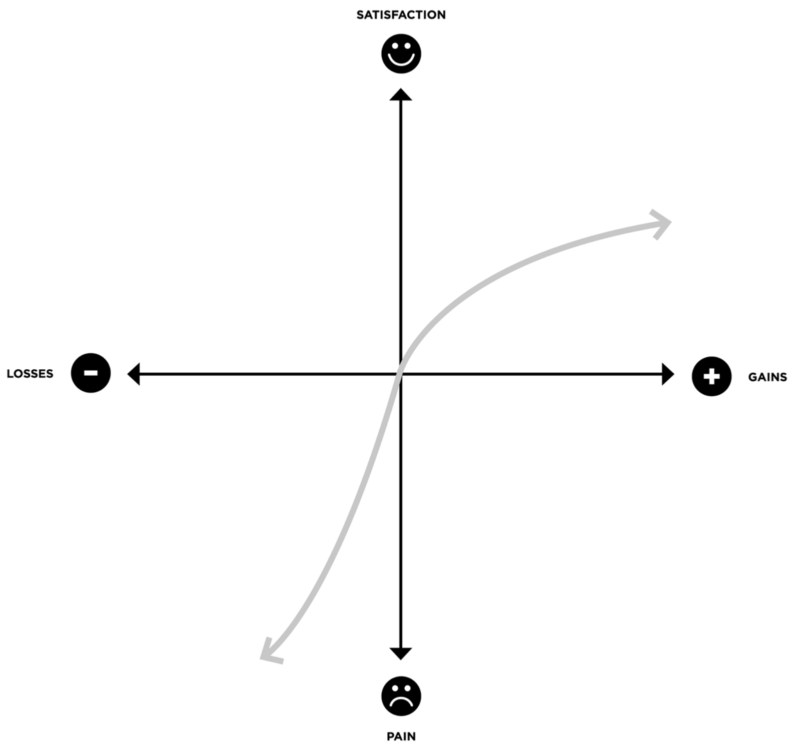

Figure 1.1 A graphic depiction of loss aversion as described by psychologists Amos Tversky and Daniel Kahneman. The gray line above the x axis "flattens" to show that the experience of pleasure derived from a gain is only half as intense as the experience of pain sustained from a loss.

Source: Kahneman, Daniel, and Amos Tversky, "Prospect Theory: An Analysis of Decision Under Risk." *Econometrica*, XLVII [1979], p. 279.

would have been wonderful to be a species that was almost insensitive to pain and had an infinite capacity to appreciate pleasure. But you probably wouldn't have survived the evolutionary battle.'"[1]

Kahneman and Tversky's work helped to demonstrate that investing, because of the asymmetry of payoffs, is *emotional*. They noted that the anticipation of winning can be highly charged, the confirmation of winning slightly less satisfying, while the prospect of loss is *grievous*![2] As a wealth advisor, it's critical for you to remember that such dynamics may be at work in the minds of your clients, even when the decision of what to do in a given client situation seems simple and straightforward to you!

The implications of Kahneman and Tversky's work were groundbreaking, shedding new light on what shapes investor and marketplace thinking. These visionaries helped to definitively explain behavioral attitudes toward risk and loss and to predict how investors often behave under conditions of uncertainty. The desire to avoid loss, for example, can be a powerful driver in investment decision-making and whether one "takes the bet" on an investment or not. In some cases, investors become frozen with fear and don't accept that they must take action to avoid losses that are on the horizon. In such instances, risk aversion overrides rational decision-making!

Thinking, Fast and Slow

Sadly, Tversky died before he could share in the honor of winning the Nobel Prize in Economic Sciences with Kahneman in 2002 for the work they did together. Kahneman went on to publish a book, *Thinking, Fast and Slow* in 2011, a book based in part on the work he did with Tversky that delves deeply into a discussion of how the brain makes decisions at one of two levels—the emotional or "fast" level (System One)—and at the purposeful, "slow" level of focused thinking, reflection, and concentration (System Two). System One thinking is generally effortless and almost automatic; people make decisions and judgments based on familiar patterns. System Two thinking requires more effort and operates in a logical and methodical way. Significantly, Kahneman notes that most people would say that they act primarily at a System Two level in daily life (exercising conscious reasoning, reflective thinking) when in fact they more likely operate at a System One level which is impulsive, automatic, and inclined to reduce life's randomness and complexities to simple truths. Keep Kahneman's typology of thinking types in mind, the next time you're trying to figure out what motivates a particular client in making investment decisions. What are the triggers? Under stress, is the client more likely to display System One thinking? Or System Two thinking? Or perhaps some combination of both?

Meanwhile, consider how "fast" and "slow" thinking differentiates the investment recommendations of the two investment advisors in Appendix A: "Thinking, Fast and Slow: The Differences in Two Philosophies of Trading."

Your Money and Your Brain

Another author whose work in the area of behavioral finance I admire and find highly useful in understanding client-advisor dynamics is Jason Zweig. Zweig has written an insightful book, *Your Money and Your Brain*, in which he discusses how scientists in the emerging discipline of neuroeconomics are making breakthrough discoveries about how the human brain assesses rewards and risks, and calculates the probabilities of gain and loss.

The Reflexive and Reflective Brain

Zweig and others have articulated compelling distinctions between what they call the *reflexive* brain and the *reflective* brain. The *reflexive* brain is driven by primitive, reptilian fears that derive from our evolutionary past. The impulses that emanate from this part of our brain are largely fear-based and hard-wired to our drive to survive. The reflexive brain is responsible for "everything from the 'startle reflex' and pattern recognition to the perception of risk or reward and the character judgments about the people we meet."[3] Thus, behaviors that emanate from this part of the brain may be driven by impulses to survive. Reflexive thinking processes tend to operate "rapidly, automatically, and below the level of consciousness."[4] In contrast, the *reflective* part of our brain is the part that behaves on a higher level, using reason and knowledge to curb impulses and to take deliberate, thoughtful action.[5]

Zweig notes that the growing use of magnetic resonance imaging (MRI) is helping to illuminate how the human brain operates in both these areas and showcases the unique evolutionary brain circuitry that becomes engaged when an individual engages in investing. He observes that when a person wins, loses, or risks money (in controlled laboratory experiments) it lights up the neural pathways of the human brain in remarkable ways, and activates strong emotions, including hope, surprise, regret, greed, and fear. "Understanding how those feelings—as a matter of biology—affect your decision-making [can] enable you to see as never before what makes you tick, and how you can improve, as an investor," says Zweig.[6]

Why Anticipating Gain Is More Intense Than Realizing It

Zweig notes that the human brain contains a region called the nucleus accumbens, which (amazingly) becomes more aroused when a person *anticipates* a profit than when he or she actually gets one. The reason?

A mechanism that researcher Jaak Panksepp of Bowling Green State University describes as the human brain's "seeking system." Over millions of years of evolution "it was the thrill of anticipation that put our senses in a state of high awareness, bracing us to capture uncertain rewards," says Zweig.[7] He cites the work of Paul Slovic, a psychologist at the University of Oregon, who says that our anticipatory "hard-wiring" includes " 'beacon of incentive' " which "enables us to pursue rewards that can be earned only with patience and commitment."[8] Zweig wryly observes that if we received no pleasure from imagining riches down the road, "we would grab only at those gains that loom immediately in front of us."[9]

What We Think Can Be Both a Blessing and a Curse

The human seeking system operates "partly as a blessing and partly as a curse," according to Zweig. That's because "We pay close attention to the possibilities of coming rewards, but we also expect that the future will feel better than it does once it turns into the present."[10]

Zweig notes that a textbook example of this phenomenon occurred in the performance of the stock of Celera Genomics Group. Back in September 1999, Celera started to sequence the human genome. Through identifying the 3 billion molecular pairings that make up human DNA, the company stood to make a huge leap in human understanding of biotechnology. Thus, investors at the time went crazy with excitement and anticipation. The stock reached a peak of $244 in early 2000. Then, on June 26, Celera announced to the world that it had actually completed its work. The stock reacted by dropping 10.2% that day and another 12.7% the day afterwards. Zweig postulates that the most likely reason the stock tanked as it did is because anticipation of Celera's DNA breakthrough was so strong that actual accomplishment of the feat was a "letdown." "Getting exactly what they wished for left investors with nothing to look forward to, so they got out and the stock crashed."[11]

The Biology of Emotion

Zweig says that while scientists have found that a person's reflexive brain is highly sensitive to changes in the amount of reward at stake, it is less responsive to changes in the likelihood of getting rewards. Say you're in a lottery where the potential jackpot is $100 million and your odds of winning fall from 1 in 10 million to 1 in 100 million. Would you be ten times less likely to buy a ticket? Apparently not, because the prospect of winning $100 million sets off such a strong burst of anticipation in the reflexive parts of the brain that only later on does the analytical (reflective) part of the brain calculate the actual probability of a win![12]

The lesson in this mini-tutorial on brain chemistry? When you buy a stock or mutual fund your "expectation of scoring a big gain elbows aside your ability to evaluate how likely you are to earn it," says Zweig. Consequently, "your brain can get you into trouble whenever you're confronted with an opportunity to buy an investment with a hot, but probably unsustainable return."[13]

Emotional Styles

Yet another author whose work in the field of neuroscience research I admire and find useful is Richard J. Davidson, PhD, professor of psychology and psychiatry at the University of Wisconsin-Madison. In his book *The Emotional Life of Your Brain*, Davidson argues that every human being possesses a unique "emotional fingerprint" comprised of six "Emotional Styles" that relate to resilience, personal outlook, social intuition, self-awareness, sensitivity to context, and attention, and that this explains why some people recover quickly from setbacks while others get trapped in a downward spiral of despair and despondency. A person's "Resilience Style" has to do with how readily they can recover from challenges or setbacks. An individual's "Outlook Style" has to do with their capacity to maintain a positive mindset, even in adverse circumstances. An individual's "Social Intuition Style" relates to one's deftness at reading social cues and clues from those around them. A person's "Self-Awareness Style" refers to their awareness of how their thoughts and feelings affect their body. A person's "Sensitivity to Context style" refers to emotional self-regulation; in other words, how good they are at managing their emotions in a particular context. Finally, an individual's "Attention Style" refers to a person's ability to screen out unwanted or unproductive emotions and stay focused on a task at hand.[14]

"Everyone has elements of each of these dimensions of Emotional Style," says Davidson. "Think of the six dimensions as ingredients in the recipe for your emotional make-up."[15]

Davidson's work has helped to illuminate for me many of the elements that go into the formation of a person's emotional template, and how a person might reasonably and predictably respond in both low-stakes and high-stakes circumstances. While Davidson focuses on how the six Emotional Styles affect a person's overall health and wellness, I believe that understanding these dimensions of emotional response (particularly those related to Resilience, Outlook, and Attention) can greatly help advisors in understanding their clients and the motivations that drive people's investing and risk-taking behaviors, especially in high-stakes circumstances.

Dealing with Emotions in Our Clients

Thus far in this chapter I've discussed the biological and psychological basis of human emotions and behavior, which, I believe, is highly relevant to our work with clients. Now, I want to pivot to talk more about how we can best understand and respond to the specific emotions and behaviors that clients display in our presence, especially in high-stakes situations.

Clearly, every individual client we work with is unique. However, I have long observed that different kinds of clients operate by displaying specific behavioral traits, and that these traits fall into one of several specific categories. For quite a long time, I struggled to come up with a typology (and taxonomy) through which to understand and organize my observations of such behaviors, and to categorize clients (without dehumanizing them) in order to develop appropriate strategies to deal with different kinds of people in different situations.

Understanding Human Behavior: A Model and Taxonomy

Then, I discovered the work and theories of Dr. David Kantor, whom I mentioned earlier. Kantor, a Cambridge, Massachusetts, psychologist and consultant, is a major thought leader in the fields of social psychology and group dynamics. His work in the area of group dynamics has been especially useful to me in decoding human motivations and behavior, understanding how people act in different situations and circumstances, and organizing my understandings about people into a practical taxonomy.

Some years ago, Kantor devised a complex, multilevel model to explain how people tend to operate in the world, an adaption of which is shown in Figure 1.2. In my opinion, this model provides a nuanced way of understanding how people show up in group settings or in one-on-one interactions with others. But it goes beyond that. It also provides a basis for understanding not only how we behave and the personalities and interpersonal styles we adopt, but *why* we behave as we do.

If you look at the model in Figure 1.2, you'll see that Kantor's model of group and interpersonal dynamics ultimately derives from the formative childhood stories we all experience as we are growing up (Level IV in the model). Our childhood stories become the foundation for all that we then become, and they reverberate with implications throughout our lives, reflected in how we appear to others in the world, how we communicate

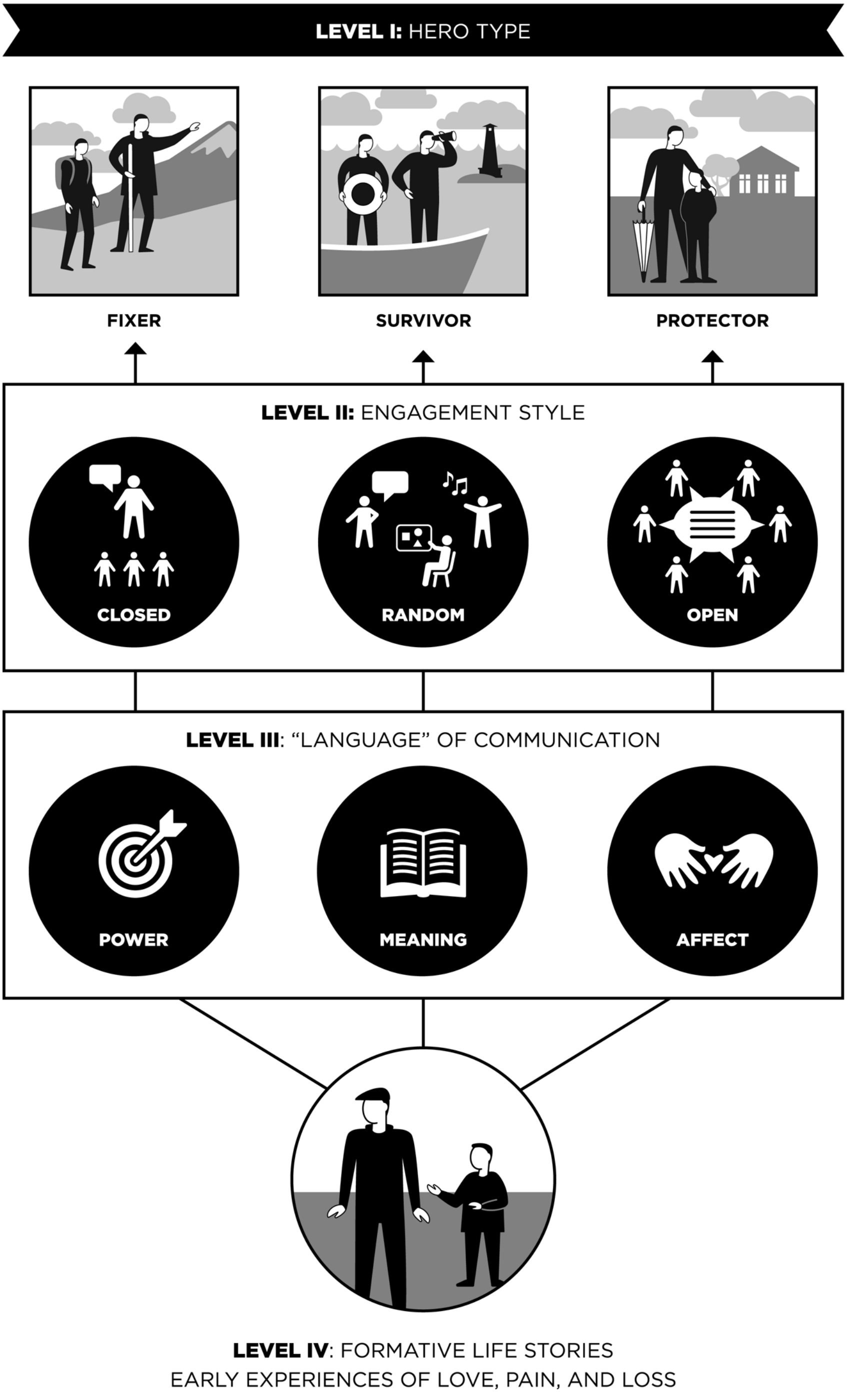

Figure 1.2 Understanding what contributes to the formation of an individual's emotional template.

with others, behave in the face of adversity and challenges, make decisions, and even in the conversational "stances" we take in conversation and group situations with others. By acquiring an understanding of this model, and how the various levels work together, it's possible to illuminate many aspects of a person's emotional template—or, as Kantor puts it, to understand a person's overall behavioral propensities profile (BPP).

So let's now look at each of these components of Kantor's model in greater detail.

Level IV: Childhood Stories

Kantor argues that much of a person's personality (emotional template) is formed as the result of childhood stories that become foundational in our development, first as children, then as adolescents and mature adults. The life "lessons" contained in our early stories (about love, loss, pain, hurt, power, powerlessness, etc.) become operating code for the development of our psyches and how we then see ourselves *vis a vis* the world. In Kantor's mind, the importance and centrality of early life stories, rooted in our first experience of the world around us, cannot be overestimated.

> We all gather stories about ourselves. From the age when we are first able to observe ourselves as objects in the world, we form and store our own experiences and identities in narrative form. Our identity and its supporting stories shape what we say and how we react to what others say. To truly comprehend the structure of talk, we want to know as much as we can about our own underlying stories and those of others.[16]

Kantor's thinking is very much in line with what other psychologists refer to as "object relations theory"—a fancy term describing the process by which people relate to others and situations in their adult lives, based on experiences they have early in childhood.

Kantor says that the realm of "personal story and identity" is not an easy one to plumb, but by doing so, we can develop a deep understanding of human nature. That's because at any moment in life human beings "are hugely affected by their own identities, their self-told stories, and the state of their private lives."[17]

When I first read of Kantor's theories about personality development they resonated with me on many levels. They spoke to the importance of understanding one's own emotional and psychological makeup, and committing oneself to the ongoing life tasks of personal development, self-actualization, and "meaning making" in all things one does. I also realized that by better understanding my own emotions, I could serve others more effectively in my capacity as an advisor.

Level III: Language of Communication: Power, Meaning, and Affect

Based on our earliest childhood experiences, all people develop preferred ways of communicating with others. Consequently, Kantor notes that all human beings tend to communicate in the "language" of *affect*, *power*, or *meaning*.

Consider how this could impact your work with clients.

Kantor says that people who communicate "in affect" tend to focus on their own feelings and those of others. Consequently, a client of yours who communicates "in affect" is likely to focus a great deal on the likely impact and implications for others of his/her investment planning or wealth management decisions.

In contrast, people who communicate "in power" tend to focus on getting things done. Thus, a client of yours who communicates "in power" is likely to be directive with you and focus on holding you to the specific investment objectives or targets the two of you may have agreed to. He or she tends to be task and results-oriented and puts more emphasis on completing tasks than on people or group process.

Finally, individuals who communicate "in meaning" are focused on the meaning and significance of their actions.[18] A client of yours who communicates with you "in meaning" is likely to focus on the logic and ideas behind specific decisions the two of you make, or to suggest and broach new ideas for the two of you to consider as part of your ongoing work together.

These "languages" of communication represent a person's overall orientation to the world and others around them, according to Kantor.[19]

Level II: Engagement Style

Just as every individual tends to adopt a specific "language" of communication, each of us also engages with others in specific ways, abiding by an "implicit set of rules" when in conversation or interaction with others. These "rules" govern how a person actually behaves, operates, and interacts with others in interpersonal and group situations.

Kantor identifies three specific engagement styles[20] that people typically display with others: open, closed, and random.

People who operate using an "open" engagement style tend to be highly social and interactive with others. They enjoy conversation, make decisions based on input from multiple sources, and work with others to achieve consensus around topics of discussion. Individuals (clients) who favor this engagement approach display a strong "give and take" attitude when interacting with others, including you, as their investment advisor. In considering investment options and plans, they're likely to want to explore many options, elicit input from you and others, and carefully weigh alternatives as part of making wealth management decisions.

People (i.e., clients) who operate using a "closed" engagement style tend to be more transactional than relational in their style of engagement with others. They're often very business-like, can dislike small talk, and focus most of their time and energy on concrete discussions of options and choices. They are disciplined decision-makers and won't be as focused on developing a relationship with you, as their advisor, as they will be on the results to be achieved by you on their behalf! A client who uses a closed system of communication with you may come across as somewhat rigid or regimented. He or she may look to you as the leader or authority in the relationship or may assume that role for themselves. In any case, when working with this kind of client it's important to explicitly "contract" around the way the two of you will work together so that expectations and roles are clear.

Finally, some people prefer to operate using a "random" engagement style. People who favor this engagement style tend to be great brainstormers. They love to kick around ideas, explore multiple options and are often highly creative (if also unstructured) in their approach to investment planning. Clients who display this preference may appear scattered, undisciplined, distracted, or unfocused in their discussions with you. It's important to meet this client where he or she is, and to provide the structure necessary to create a successful client-advisor relationship. I'll have much to say about engagement styles in Chapter Four.

Level I: "Hero" Types

Given that we are all shaped by early life experiences, our personalities inevitably take form and develop specific characteristics. Kantor says that human beings tend to exhibit one of several specific "hero types" in their daily existence, and that these can be observed both in low-stakes and high-stakes situations but are especially critical to understand in high-stakes situations. These "hero types" include the "Fixer," the "Survivor," and the

"Protector."[21] I briefly noted examples of each type earlier in this chapter. Each is characterized is by its own set of unique behaviors and motivations.

Fixers. Fixers are individuals who have an indomitable will that motivates them to overcome whatever obstacles come their way. It might be an enemy, adversary, or a unique personal challenge or threatening situation—a plunging stock market for example! Under normal, everyday (low-stress or low-stakes) circumstances, "Fixers" can be charming, even charismatic. In high-stakes situations, Fixers can change radically, becoming power hungry and overly controlling. Fixers generally operate in the language of "power." If you have a Fixer for a client, you generally know it. They like to be in charge and in control!

Survivors. Survivors operate largely in the language of "meaning." Strong belief—in causes, people, values, even specific approaches to investing—leads Survivors to be willing to sacrifice themselves, often "to the dismay of those they love," says Kantor.[22] Survivors often come across as martyrs or champions of noble (if sometimes) lost causes. If you have a Survivor client and the markets are in free fall, the Survivor is likely to say to you, "I'll get through this; I know I will!" Under extreme circumstances, Survivors dig their heels in. A cause can become a fanatical obsession. And when things don't go their way, they can often lash out at others, including you, as their financial advisor.

Protectors. Protectors operate primarily in the language of "affect." They use the language of feeling and emotion fluently, are focused primarily on the care of and consideration of those around them, and have a strong ability to empathize with others, even when faced with difficult decisions. If you have a Protector as a client you'll know it, because as part of their estate, investment, and retirement planning activities they are likely to talk in depth about others, including spouses, children, family members, and friends. They are guardians, stewards, and caretakers by nature.

Kantor says that the traits of each hero type become increasingly pronounced in an individual as the pressure or stress on a person increases, and they see themselves at risk or in circumstances of increasing stakes. From my professional experience, the traits of each "hero type" become abundantly clear in financial discussions with clients when markets become volatile or when a client suddenly has to deal with personal, financial, or family uncertainties and/or the threat or reality of financial losses. When a person's life circumstances change from low stakes to high stakes Kantor describes this as going from living in the "light zone" (low stakes) to the "gray" zone (intermediate stress or pressure) to the "dark" (or high stakes) zone—sometimes called the "shadow." As you'll discover in later chapters, when a client begins to operate in their "dark" zone (under circumstances of high pressure or stress) it can become problematic for an advisor to deal with.

Understanding Human Motivation and Action

The four-level model outlined by Kantor is a powerful framework through which to understand human emotions and behavior and provides an elegant way to comprehend and appreciate different behavioral styles/tendencies that you may observe in your clients. I like to think of it as a kind of "unified field theory" (theory of everything) that goes a long way toward explaining the nature and origin of all human emotion and action.

Later chapters of *Working with the Emotional Investor* will explore the various elements of Kantor's structural dynamics model in much more detail and provide you with strategies and insights for dealing with people who display the behavioral propensities of Fixers, Survivors, and Protectors in a variety of circumstances, but particularly in high-stakes situations.

For now, suffice it to say that I believe Kantor's BPP model provides a unique and rich way to look at the origins and nature of human emotions and motivations in both low-stakes and high-stakes situations. For us as wealth advisors, however, the practicality of the model's use in high-stakes client situations is particularly important.

Chapter Conclusions

In this chapter I've discussed the origins of the human "emotional template" (psychological system), which has its basis in both evolutionary biology and formative life stories that help shape our psyches as children, adolescents, and adults. I've also talked about how evolutionary biology and brain function shape human emotions and behavior—including risk-taking and investing—and have introduced a framework (Kantor's model) for understanding how our formative early life experiences (stories) go on to shape our psyches, emotions, behaviors, beliefs, and formation of "hero" types under situations of high stakes.

To be an effective wealth advisor today you must not only be a knowledgeable wealth management and investment planning expert but also a sensitive, self-aware, and discerning observer of human nature, behaviors, and motivations. By understanding all these factors, you'll be able to serve your clients in ways that your colleagues cannot. For you will bring the hugely important component of emotions and behavior to bear, not only to better understand your clients and what makes them tick but to work with them in a way that is aligned with their emotional nature and temperament. You will learn to observe, discern, and map courses of action with clients, based on your knowledge of their emotional template, and learn how this drives and shapes their behavior, beliefs, values, and goals in high-stakes situations.