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WHITE PAPER

Approaching Client Portfolio Reviews During Difficult Times

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In today's challenging economic climate, Financial Advisors (FAs) must face the daunting task of managing quarterly client reviews. Markets are volatile, inflation rates are still above the Federal Reserve's target level, and the labor market remains tight. Clients are worried about inflation, interest rates, job security, climate change and sustainability. They are changing their purchasing habits, looking for bargains.[1] Still, FAs must conduct portfolio reviews.

With these challenges in mind, this paper examines how to prepare for and deliver an effective review meeting that addresses client concerns and improves the working relationship between the FA and the investor.

1 Tamara Charm, Nancy Lu and Kelsey Robinson, "US Consumers Send Mixed Signals in an Uncertain Economy," McKinsey & Company (April 28, 2023)

Be Prepared for Client Reviews

For a number of years prior to the outbreak of COVID-19, clients had been enjoying mostly benign markets and happily expecting positive returns to be discussed in pleasant review conversations with their FA a few times a year. But the coronavirus attacked the world, capital markets reacted, and portfolios suffered rapid and largely unprecedented losses. Markets rebounded, but then fell again in 2022. Today, many forecasters expect the country to slip into a recession in the second half of 2023.

Prudent advisors know that clients are more anxious about their portfolios in this environment. In addition, FAs recognize that discount brokerage firms and robo-advisors are pressuring their pricing models. The truly savvy advisor prepares for potentially uncomfortable portfolio reviews by considering six key ideas before beginning discussions with clients.

1. This Is Not Your Usual Review: Things Are Very Different

Clients are deeply impacted by daily events. COVID-19 is still infecting our friends. Some people are still masking in public areas and avoiding social gatherings. Every news channel on every medium concentrates on shocking reports about the global economy, conflicts around the world and possible economic disaster. Many adults still work from home or have opted for early retirement. The bottom line is that pre-pandemic routines have changed, and we are still working out the "new normal."

Financial Advisor Tip #1

Simply waking up and paying attention to the world make clients aware that something is significantly wrong. This inevitably leads to feelings of threat and personal danger.

Financial Advisor Tip #2

The savvy FA knows that clients will come to their review distracted by the day's news cycle and adopts a different approach to managing the review.

2. The Brain Works Differently During Turbulent Times: The Challenge of Impulsivity

As behavioral economist Daniel Kahneman explains in his book *Thinking, Fast and Slow*, the human brain switches back and forth between two decision-making systems, which can present a challenge during a client review. In normal times and during benign markets, clients are likely to come to their review with a (mostly) rational mindset about their investments. Even when there's a disagreement, most clients hear you and follow your guidance. Kahneman calls this logical and deliberate decision-making process the "slow-thinking" system.

When the world turns upside down, clients are emotionally impacted and feel threatened. This activates the brain's "fast-thinking" system, boosts the natural fight-or-flight response and shifts focus away from rational processes toward impulsive actions. The unfortunate results are that clients are less able to listen to and understand what the FA is saying and are very impatient with complicated explanations. *At the precise time clients need professional advice most, they're least able to hear, receive and use it.*

3. Establishing Guiding Principles: The Stockdale Paradox

Despite impatience with details, clients typically want more than a brief report on their portfolio's performance. Most will be interested in learning your perspective on the market's behavior. Anticipate this by preparing a sophisticated point of view about the capital markets that provides insight on what has happened, the mechanisms that impacted portfolio performance and what's likely to happen in the future.

Financial Advisor Tip #3

Before the meeting, plan what you're going to say, find research-based information and practice your presentation.

In his book *Good to Great*, Jim Collins discusses Vice Admiral James Stockdale, the highest-ranking military officer in the "Hanoi Hilton" prisoner-of-war camp during the height of the Vietnam War. Stockdale is credited with saving hundreds of his fellow soldiers' lives by the way he led while in captivity. He accomplished this by offering two commitments a leader must make to his people during a crisis: first, a credible leader must be brutally honest about the situation the group is in; second, the leader must find a rational reason for hope.

4. Some Questions Are Predictable: How to Anticipate Client Queries

Although each client is unique and has values and reactions that differ from other clients, emotional responses to difficult times are universal. Expect clients to have questions and concerns.

The vocabulary may be different, but the queries are the same. Be prepared with well-crafted responses; don't ad-lib. Here are some common questions you may hear from clients:

- Do you see what I see? Are you as concerned as I am?
- Do you know more than I do? Do you know what this market behavior means?
- Do you have a point of view on the markets? Is there any reason for hope?
- Do you know what we should do next? What are your specific recommendations?
- Do I have reason to believe that the future I want, that we've been working toward, is the future I am still likely to get? Can I trust that your process will get me there?

5. Controlling the Narrative: The Role of Financial Planning and a Capital Markets Perspective

When clients are distressed, they tend to oversimplify problems they're facing—an automatic process that Kahneman called narrow framing. Expect clients to come to this quarter's review with an oversimplified perception of their investments and a comparison of their portfolio's performance either to a benchmark or (worse) to someone else's investment results.

Recognize that neither is healthy. The portfolio was constructed based on decisions designed to achieve a set of desired outcomes sometime in the future. These outcomes are usually quantified as financial goals, and they determine how the portfolio should function, what it should be composed of and how much risk should be taken. Without defined goals, neither the FA nor the client can assess if the portfolio is working.

In addition, the portfolio cannot be judged as effective or ineffective without understanding the capital markets in which it performed. Being up 10% when the markets are up 25% indicates poor performance—*unless* the design of the portfolio is to reduce investment risk. In a similar way, being down 10% is great news when the capital markets suffer a 25% loss.

Financial Advisor Tip #4

Even if the client doesn't ask outright, providing answers to common questions increases a client's confidence in your leadership and your credibility as a professional advisor.

Financial Advisor Tip #5

Assessing the client's financial plan and long-term goals and the capital markets' behavior before reviewing the portfolio's performance lets the FA avoid examining results without the appropriate context, eliminates narrow framing and oversimplification, helps the client make more informed decisions, and allows the client to have increased confidence in the advisor.

6. Putting It Together: A Seven-Step Structure to Manage the Meeting

Here are seven highly actionable steps to manage upcoming client reviews.

Step One: Engage and Listen
Start the review by putting the client's brain in a more rational and receptive state. Begin by saying, "We set up this time to review your financial plan and to talk about your investments. I'd like to begin by checking in and seeing how you're doing. This has been a challenging time for everyone; how have you been feeling?"

Asking this type of open-ended question forces the client to engage the slow-thinking part of the brain and use language skills to respond. Spend 7–10 minutes just listening and encouraging the client to talk. The remainder of the client review will go much more smoothly if the rational part of the brain is activated and the fight-or-flight stress response is minimized. For more information on the use of open-ended questions in a client review, see the AllianceBernstein Advisor Institute's program *Managing the Hard Conversation*.

Step Two: Present Your Professional Point of View on the Markets
Once you've allowed the client to process her feelings, she can process the information you will be providing. Continue the review by saying, "Before we dig into the portfolio, I'd like to take a few minutes to look at what happened over the past quarter and discuss what we think is likely to happen going forward."

It's helpful to use the common questions discussed earlier to guide you in selecting what information to provide and how you organize your presentation. For more details on presenting your point of view on the markets, see the AB Advisor Institute's program *How to Present Your Capital Markets Perspective*.

Step Three: Review the Financial Plan and Confirm the Client's Goals
The most important questions clients need answered are "Do I have reason to believe that the future I want, that we've been working toward, is the future I am still likely to get?" and "Can I trust that your process will get me there?"

Confirming the client's goals before reviewing the portfolio establishes the portfolio's role *in the context of the client's goals and plan*. It also provides an opportunity to begin this part of the conversation on a positive note: despite recent market turmoil, the client's goals are likely to be realized. Even if those goals are challenged, you can discuss various strategies to make those goals more achievable. Either way, clients can feel a greater sense of control and confidence about their situation *regardless of what is happening around them*.

Step Four: Discuss Portfolio Performance
The context has been set, and the client has been educated on recent market performance and reminded about his specific financial goals; now it's safe to explore the portfolio's performance. The prudent FA is cautious about the client's tendency to use narrow framing in this part of the conversation by zooming in and considering only the most recent market/portfolio behavior. Start by connecting the portfolio's behavior to the capital markets, then zoom out and consider longer periods of time. This helps the client understand what happened recently and can highlight the fact that, despite recent losses, gains have been achieved over the past few years.

Next, connect the portfolio to the client's goals; don't merely compare it to common benchmarks. Constantly connecting the portfolio to the client's objectives reinforces the long-term nature of investing and how the portfolio is instrumental in creating the future the client wants.

Conclude this step by reporting on any actions that were taken during the period being reviewed, especially those that were intentionally designed to protect the client or take advantage of an opportunity. The action-oriented instinct of the client will appreciate moves taken on his behalf. If appropriate, this is also the time to suggest new transactions designed to respond to current market conditions.

Step Five: Address Concerns
It's likely that one of two scenarios will occur as the portfolio is reviewed. Rational clients will ask questions that deserve to be explored and answered thoroughly. Following Stockdale's leadership principles, provide a brutally honest assessment of what has happened and why, what's likely to happen next, what actions have been taken, and what actions, if any, can be taken now.

Provide rational reasons for hope about the future, both by appealing to timeless principles of investing and by pointing out various positive mechanisms that are likely to play out over time. Focusing the client on the future increases the likelihood of goals being achieved and reminds us that, over the long term, markets often trend upward. This can restore feelings of confidence in the process and a positive vision of the future.

Less rational clients tend to be impatient and may resort to blaming the advisor for a perceived failure. This represents a desire to undo what has happened or try to go back to the past and change something in order to avoid the current pain. If this happens, attempt to engage the client's slow-thinking brain. After a couple of efforts, it may be necessary to surrender. Some clients are unable to metabolize negative feelings and engage in a thoughtful dialogue.

In these cases, especially when the client is blaming the FA for a failure, try this strategy to move the client back toward a rational inquiry. If you realize the client isn't listening or needs to assign blame for the losses in the portfolio, try saying, "You sound hurt and angry about what has happened in the portfolio this quarter." Allow the client to reflect on how she feels. Remember that she is in a highly emotional state of mind and cannot hear you, so don't try to defend what has happened.

Sum up her feelings with the following statement: "You sound angry that I didn't do a better job of predicting the future and avoiding this problem." This allows the client to put words to what she is feeling; in many cases the client will say, "Yes! What do you think I am paying you for?"

You can now help the client think more clearly about her expectations: "I totally understand how you feel. I certainly would like to be able to predict the future, but I know that I can't. May I ask you: Do you think that there is a Financial Advisor who can predict the future?" This usually stimulates the slow-thinking part of the brain enough for the client to achieve self-awareness and realize that what she wants is impossible. When this happens, you can return to an exploration of the portfolio, new strategies and reasonable expectations.

If the client responds that she thinks such advisors exist, ask: "If they could actually predict the future like that, why would they sell you that skill for a 1% fee? Wouldn't they keep that a secret?" This can help the client recover her rational thinking patterns by gently confronting her irrational expectations.

Step Six: Confirm Next Steps

Verify any actions that you, your team or the client will take.

Step Seven: Set the Time for a Check-In Call in the Near Future

As events continue to unfold, the wise FA will contact clients more often. Advisors who worked through the last two major market corrections report that more frequent contact resulted in stronger bonds and deeper appreciation in the months and years that followed. Even clients who offer reassurance that they don't need check-ins often value the compassion shown by the FA who reaches out consistently.

Conclusion

Advisors who follow these seven steps will be able to control the flow of the review meeting, help each client achieve a greater degree of confidence about the future, and provide greater credibility for the FA and the financial plan. By successfully navigating challenging times, you can build a stronger bond of trust that potentially solidifies into a permanent link, the benefits of which cannot be overstated.

The end result: a stable relationship for years into the future.

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