
The Psychology of Volatility: A checklist for client conversations during turbulent markets

Investing is more than a mathematical analysis of risk and return. It's a struggle with ourselves to tune out irrelevant information, to have the strength to stick with the plan, and to resist the urge to follow a fearful herd.

Morningstar's behavioral insights team created this conversation checklist to help advisors guide their clients through this internal struggle and stay on track with financial plans during market turmoil.

Scenario 1: Markets are dropping, and a client calls you to find out how to respond

- **Protect against the psychology of panic.** Talk to your client about how we all can fall prey to biases and panic, so we should expect it, then handle it.
 - ▶ Share how our emotions can be our own worst enemy when it comes to investing. Fear narrows attention and induces people to fixate on short-term headlines, rather than long-term goals.
 - ▶ Strengthen that point with supplementary information, such as [this article](#) that explains where these emotions come from and how we can overcome them in investing.

- **Set the right narrative.** A key lesson from behavioral finance is that raw information (like volatility) can be interpreted many ways, depending on the narrative. As an advisor (and behavioral coach), you have an opportunity to set that narrative, using core lessons from behavioral finance:
 - ▶ Many people run away from falling markets, and because of that, it can present opportunities for finding good values in the marketplace.
 - ▶ Short-term volatility is an inevitable part of investing. That's why our focus is on long-term performance toward investor goals
 - ▶ Remind your client that their financial plan was developed with their goals in mind, and (if they are) that they're still on track to meet their long-term goals with their current asset allocation and time horizon.

- **Set up future frictions.** If a client is paying attention to what's going on in the outside world but hasn't panicked, it's an ideal time to prepare for future concerns. In particular, you can agree on intentional points of friction that will help your client take a step back from their emotions if they start feeling panicked later:
 - ▶ Agree on a three-day wait rule, where you can't act on certain client decisions for three days.
 - ▶ Agree that a loved one or a spouse must sign off on certain client decisions before you can act on them.

- **Commit to the future.** Ask your client to write a letter to their future selves. This letter should entail two things: why your client started investing in the first place ([their goals](#)) and why it's important to stick to their financial plan no matter what. This letter then becomes a promise to themselves to hold steady throughout volatility.

Scenario 2: Markets are dropping, and a client calls you, panicked

- Review the techniques above.** Depending on their emotional situation, you may still be able to:
 - ▶ *Teach in the moment* on the universal nature of our investing biases—researchers have found that these insights on how we *all suffer from them* can help people recognize and overcome them.
 - ▶ *Set the right narrative* of opportunity, of countering the herd, looking for long-term value, and focusing on goals.
- Focus on something else: Goals.** Remind your client why they are investing in the first place. This can be accomplished with a simple conversation regarding their investing goals or an in-depth exercise that helps slow down and dig into the goal-generation process.
- Focus on helping others.** One way to help your client break free from an undue focus on short-term performance is to focus on the good they can do for others—in both daily life and investing.
- Decrease the noise.** Ask your client to ration their access to the news. Try setting up rules for when to catch up on market news. Researchers have found that the more frequently people look at market news, the more it warps their investing behavior. Some financial media is designed to be sensational and attention-grabbing, but this kind of approach typically doesn't promote even-keeled, long-term thinking. Encourage your client to turn down the noise.
- Practice anxiety reappraisal,** which is reframing nervousness as excitement. Help your client see a downturn as a way to buy securities at a discount.

Scenario 3: Markets are dropping, and a client hasn't called. Should you be proactive?

- Prepare, but wait.** Get your response and the information you need to support it ready, but don't assume they are panicked. People close to the industry feel volatility much more, and faster, than people outside the industry. There's some initial evidence that reaching out to people and telling them "don't panic" gives them a signal that they *should* panic.

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