



# Behavioral Finance: From Academic Research to Client Discussions

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## Outline

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- History, Researchers, and Seminal Papers – Drew Hanks
- Common Biases & Heuristics – Cäzilia Loibl
- Research Applied – Eric Olsen

## What is Economics?

- How people, businesses, institutions, governments, etc., allocate scarce resources
- Personal Finance: how people allocate financial resources for current and future consumption

## Key Assumptions

- People know what they like and are consistent in their choices
- People have all the information they need to choose... [fill in the blank]
- People think ahead and perfectly plan their futures
- Silly things like emotions and circumstance do not affect behavior

## Have your clients ever...

- Called you when the market begins to dip?
- Not followed through with commitments such as rolling over an IRA?
- Made a big unplanned purchase that affected their investment plans?
- Not fully recognized the long-term ramifications of short-term financial decisions, such as waiting to save, going over budget on a home purchase, or [...fill in the blank...]



## So... why aren't **your** clients like Spok?

- 19<sup>th</sup> and 20<sup>th</sup> century evolution of economic thought led to “mathematization” of economics and finance
- But...
- Adam Smith, father of economics, understood people are ...well...people
  - People hate losses more than they love gains (think financial losses...)
  - People think they know more than they do (how many clients think they know more than you, or **they can learn on their own**?)
  - Preferences for short-term vs. long-term gains (buy that boat instead of invest...)

## Nobel-Winning Work

- **Herbert Simon – 1978**
  - Nobel prize for Bounded Rationality – people make decisions based on limited information and limited cognitive resources
- **Amos Tversky and Daniel Kahneman – 2002**
  - Nobel prize for Prospect theory – loss aversion, mental accounting,
- **Richard Thaler – 2017**
  - Nobel prize for contributions to Behavioral Economics and Finance – tests of proposed theories
- **Esther Duflo, Abhijit Banerjee and Michael Kremer – 2019**
  - Nobel prize “for their experimental approach to alleviating global poverty”

## In Summary...

**System 1**

**VS**

**System 2**

Note: Behavioral finance is a specific application of behavioral economics



## Become part of our growing CFP financial planning program at Ohio State

- **Pro bono Financial Planning “Community Project”**: Team up with 2 new financial planning students to offer a financial planning session by Zoom to students with financial questions/problems, *2-3 hours/semester*
- **Teach part-time in our financial planning program**: Currently seeking instructors for FINRA SIE Exam, FINRA Series 65, general personal finance course; *Master’s degree required*
- **Offer internship positions**: Over 100 students enter our CFP Board approved financial planning track every year. Internships are critical for creating commitment to the profession!

## Become part of our growing CFP financial planning program at Ohio State

- **New CFP Program Director position:** Seek a CFP professional for 30 hours/week from August 15 to May 15 (summers are off) to lead marketing and student placement, *starting August 2025*
- **Donate \$3,500 to help a student sit for the CFP Exam in March 2025:** New effort to have our graduating seniors to sit for the exam while at Ohio State. Funding needed for exam books (\$1,000), professional review course (\$1,500), and exam fees (\$825)

Contact Dr. Loibl ([loibl.3@osu.edu](mailto:loibl.3@osu.edu))! Thank you!

## Common Biases & Heuristics

# Principles

### Behavioral finance in financial planning:

- Charles Schwab: “Behavioral Finance Barometer” 2019 and 2021, survey of 301 financial advisors
  - <https://www.schwabassetmanagement.com/lessons-behavioral-finance>
- MetLife Foundation: “Behavioral Economics Field Guide for Financial Services,”
  - [https://advanced-hindsight.com/archive/wp-content/uploads/downloads/2015/12/CAH\\_Field-Guide\\_FinancialServices.pdf](https://advanced-hindsight.com/archive/wp-content/uploads/downloads/2015/12/CAH_Field-Guide_FinancialServices.pdf)



## Famous readings

### **Biases & Blunders**

The human mind is incredibly powerful, but it is also susceptible to a variety of systematic, predictable mistakes.

### **Two cognitive systems**

- System 1 is automatic, uncontrolled, effortless, associative, fast, and unconscious
- System 2 is reflective, controlling, effortful, deductive, slow, self-aware, and rule-following
  - System 1 evolved earlier and is generally more powerful

### **Choice architecture**

Designing choice processes that are efficient and conducive to health and wellbeing

### **Nudges**

Low-cost tools that alert, remind, or mildly warn people by molding behavior in powerful ways.

## Common Biases & Heuristics

# 1. Recency Bias

### People tend to put too much emphasis on recent events

- Investors think that a current stock market downturn or rally will extend into the future; ignore future periods of market volatility
- Clients make short-term decisions that deviate from their financial plans

### Financial Advisor:

- Educate clients about recency bias



Source: Charles Schwab Asset Management. 2021. Fundamentals of behavioral finance.  
URL: <https://www.schwabassetmanagement.com/content/recency-bias>

## Common Biases & Heuristics

# 2. Loss Aversion

**Pain of a loss is felt more strongly than an equivalent gain**

- Clients prioritize avoiding losses
- Portfolios can be too conservative, below the growth potential they need

### **Financial Advisor:**

- Educate clients about loss aversion

Source: Charles Schwab Asset Management. 2021. Fundamentals of behavioral finance.

URL: <https://www.schwabassetmanagement.com/content/loss-aversion-bias>



## Common Biases & Heuristics

### 3. Confirmation Bias

#### Seek out information that supports one's beliefs

- Investors focus on information that reinforces their opinions; selectively choose information
- Lack of diversification and imbalanced investments

#### Financial advisor:

- Implement systematic processes for activities, such as trading and rebalancing
- Shift clients' focus to long-term goals



## Common Biases & Heuristics

# 4. Familiarity/Home Bias

### Tendency to prefer what feels comfortable

- Overexposure to U.S. stocks or shares of certain companies
- Can mute the benefits of diversification and increase risk

### Financial Advisor:

- Explain the reasons for a well-diversified portfolio
- Educate clients about home bias may lead to better long-term results



Source: Charles Schwab Asset Management. 2021. Fundamentals of behavioral finance.  
URL: <https://www.schwabassetmanagement.com/content/home-bias>

## Common Biases & Heuristics

# 5. Overconfidence

### Tendency for a person to overestimate their abilities

- Clients act as better-than-average investors
- Can lead clients to overly risky investments

### Financial Advisors:

- Engage clients in discussion about wider perspectives
- Pre-emptive planning for a measured approach to making financial decisions

#### JOURNAL ARTICLE

### Boys will be Boys: Gender, Overconfidence, and Common Stock Investment [Get access >](#)

Brad M. Barber, Terrance Odean

*The Quarterly Journal of Economics*, Volume 116, Issue 1, February 2001, Pages 261–292,  
<https://doi.org/10.1162/003355301556400>

**Published:** 01 February 2001

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#### Abstract

Theoretical models predict that overconfident investors trade excessively. We test this prediction by partitioning investors on gender. Psychological research demonstrates that, in areas such as finance, men are more overconfident than women. Thus, theory predicts that men will trade more excessively than women. Using account data for over 35,000 households from a large discount brokerage, we analyze the common stock investments of men and women from February 1991 through January 1997. We document that men trade 45 percent more than women. Trading reduces men's net returns by 2.65 percentage points a year as opposed to 1.72 percentage points for women.

Access:

<https://faculty.haas.berkeley.edu/odean/papers/gender/boyswillbeboys.pdf>

Source: Charles Schwab Asset Management. 2021. Fundamentals of behavioral finance.

URL: <https://www.schwabassetmanagement.com/content/overconfidence-bias>

## How to approach cognitive biases in clients?

### System 2: Inform and educate to reduce biases

- Recency bias
- Loss aversion bias
- Confirmation bias
- Familiarity bias
- Overconfidence
- .... and many others

### Better use System 1!

#### Use client biases to your advantage

- Anchoring to numbers
- Sub-goals vs big overarching goals at different times in the planning
- Accountability to social network
- Implementation intentions to increase actions
- “Save More Tomorrow” study to avoid self-control failure – next slide



# “Save More Tomorrow” Research Study

JOURNAL ARTICLE

## Save More Tomorrow™: Using Behavioral Economics to Increase Employee Saving

Richard H. Thaler and Shlomo Benartzi

Journal of Political Economy

Vol. 112, No. S1, Papers in Honor of Sherwin Rosen: A Supplement to Volume 112 (February 2004), pp. S164-S187 (24 pages)

Published By: The University of Chicago Press



<https://doi.org/10.1086/380085>

<https://www.jstor.org/stable/10.1086/380085>

## Research Applied

# What is Academic Research?

- Quantitative vs. Qualitative
- Bi-variate vs. Multi-variate
- Positive vs. Normative
- Descriptive vs. Causal
- “Standing on the Shoulders of Giants”



## Research Applied

# The Importance of Academic Research

- **What place does academic research have in the practice of financial planning?**
  - Asset management, portfolio construction, distribution rates, etc.
  - Behavioral finance biases and heuristics
- **“Research driven” financial planning – three sources of information**
  - Wall Street vs. Main Street vs. Academia
- **Beware of oversimplification of BeFi topics (e.g. Loss Aversion)**
  - Beyond “how investors / clients behave”

## Research Applied

# “The Psychology of Decision Making”

## Two Areas for Implementation:

- 1. Portfolio construction / Asset Management**
  - Use systems (e.g. rules)
  - Know your weaknesses
- 2. Client communication / Interactions**
  - Better understanding
  - Better implementation (e.g. pre-commitment)
  - Build confidence in your expertise

Source: Charles Schwab Investment Management. 2019. The Role of Behavioral Finance in Advising Clients.

## Research Applied

# Have Some Fun With It

- **Goal: make your clients say, “huh”**
  - Biggest “bang for the buck” in the counter-intuitive
- **Coin flip, which of the two sequences is more likely?**
  - H-T-H-H-H-T-T-H-T-H
  - T-T-T-T-T-T-T-T-T-T
- **Linda the teller**
- **Mugs and chocolate bars**

## Firsthand Experience

- **Those legacy positions**
  - Endowment Effect
- **“As soon as it gets back up to what we paid for it...”**
  - Anchoring
- **“I made some great picks but then the market turned on me”**
  - Attribution Bias
- **Teaching undergrad finance**
  - Herding/Recency biases

## Research Applied

# Where would I start?

- **Read the Charles Schwab The Role of Behavioral Finance in Advising Clients and BeFi Barometer 2021 documents, start to learn the most common terms**
  - Challenge yourself in your next client meeting to correctly use one or two of them
- **Create a list of procedures around specific biases (asset management and/or communication)**
  - Have clients write down by how much they will increase their monthly taxable investing (pre-commitment)
- **Create a BeFi checklist for each client in your CRM, indicating their top 3 biases of which to be aware**
- **Develop your BeFi knowledge base, next slide...**

## Research Applied

# Where would I start? Popular Books

- **Thinking Fast and Slow by Daniel Kahneman & Amos Tversky**
  - Undoing project by Michael Lewis
- **Nudge by Richard Thaler & Cass Sunstein**
  - MisBehaving by Richard Thaler
- **The Behavioral Investor by Daniel Crosby**
- **The Psychology of Money by Morgan Housel**
- **Thinking in Bets by Annie Duke**

## Research Applied

# Where would I start? Professional Resources

- **CFP.net**
  - The Psychology of Financial Planning (<https://www.cfp.net/knowledge/psychology-of-financial-planning>)
  - Warton virtual program & Client Psychology (<https://www.cfp.net/initiatives/knowledge-for-practice/client-psychology-program>)
- Vanguard Advisor's Alpha® (<https://advisors.vanguard.com/advisors-alpha/>)
  - Putting a value on your value: Quantifying Vanguard Advisor's Alpha®
  - Behavioral coaching 0 to > 200 basis points



**Thank you for your attention!**

Please keep in touch!

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