Learning from Disruptive Market Events: A Study of Financial Advisor Behavior

Philipp A. Hensler*, Tony Lingham, Sheri Perelli

Case Western Reserve University, philipphensler@mac.com

Abstract

The static portfolio construction process, while an efficient, rational and stunningly successful strategy for allocating client assets in well behaved markets, may prove less so in disruptive markets when active financial advisor intervention may be necessary. The literature is silent about how financial advisors learn from market dislocations and how market dislocations affect their asset allocation practices. Semi-structured interviews with 30 senior US financial advisors yielded insights about their allocation decisions prior to and after the 2008 financial crisis. Post crisis persistence in beliefs and behaviors are attributable to an enduring belief in recurring historic patterns, unwavering reliance on traditional model assumptions and active time horizon management. Furthermore, striking differences in cognitive capacity and perceived locus of control distinguish the post-2008 practice of most financial advisors from the relatively few who have adopted more dynamic portfolio management approaches.

Findings should be of interest not only to financial industry professionals but to the clients who rely on their advice.

Keywords: Financial crisis, financial advisors, disruptive event, individual learning, organizational learning

Introduction

The 2008 financial market crisis put an abrupt end to the honeymoon period of static asset allocation models (Solow, 2009) which were dogma for financial planners during a time of steadily rising markets and low volatility (Mishel, Mishel, Bernstein, & Boushey, 2003; Jahnke, 2004). With the most popular asset allocation portfolios losing 17% to 40% in 2008 (Ibbotson Associates, 2009), more tactical and adaptive allocation strategies have been suggested (Waldert, 2010).

Most asset managers, however, continue to rely on the tenets of Modern Portfolio Theory proposed by Markowitz (1952, 1959), Sharpe (1964), Lintner (1965), and Fama (1965) when managing clients' money (Horsesmouth, 2008). Unlike some large institutional managers, who employ dynamic allocation strategies, financial planners use the static "buy and hold" approach as it is easy to market and implement (Jahnke, 2004). However, while static allocation models make sense in stable and predictable environments (BNY Mellon Wealth Management, 2009), they are very sensitive to dramatic changes such as the 2008 market dislocation (Jahnke, 2004) when financial advisor intervention to protect clients' assets is paramount. Unfortunately, there is insufficient knowledge about how financial organizations and advisors respond to and perform in highly volatile and disruptive market situations.

The claim that unexpected incidents or failures are a prerequisite for learning has found widespread expression in social psychology and organizational behavior literature (Sitkin, 1992; Zakay, Ellis, & Shevalsky, 2004). How such experiences are transformed into knowledge (Kolb, 1984) and how this knowledge precipitates change in behavior or mental models (Argyris & Schön, 1978; Huber, 1991; Friedlander, 1983) has not been systematically researched with respect to financial advisors. As a consequence, important questions such as whether and to what extent the 2008 market dislocation triggered advisor learning and what advisors are doing differently to better serve clients remain unanswered. Also less researched is whether the environment in which advisors operate facilitates adaptation to new situations.

To bridge this gap, we designed an exploratory study based on semi-structured interviews with 30 long tenured US financial advisors. We sought to generate a grounded theory about how, and to what extent, advisors learn from and adapt to unexpected market dislocation. We did so through rigorous analysis of rich narratives comparing and contrasting client communication and asset allocation strategies prior to and after the 2008 financial crisis. Our work contributes to the literature on learning from disruptive events in the unique context of financial advisors. It should be of interest to financial planning firms looking to better develop advisors who can respond to turbulent economic events.

Literature Review

Empirical research on the role of financial advice in portfolio composition is scarce (Jansen, Fischer, & Hackethal, 2008). Most research in this field focuses on recommendations from security analysts, but few studies have evaluated the influence of professional financial advice (e.g., Avery, Bostic, Calem, & Canner, 1997; Elton & Gruber, 2000).

Over the last 30 years, most financial advisors have embraced the rational choice assumption of Modern Portfolio Theory as the foundation of their financial planning work, despite extensive evidence that households deviate considerably from rational investment behavior (Goetzmann & Kumar, 2004, 2008; Hirshleifer, 2001; Korniotis & Kumar, 2005). Rationality has its limitations as decision makers are bounded by their values and unconscious reflexes, skills, and habits (Simon, 1956) including cognitive and affective biases (De Bondt & Thaler, 1985; Hirshleifer, 2001; Kahneman & Tversky, 1973, 1979, 1981; Shefrin & Statman, 1994; Slovic, 1972). The world is not perfectly rational and cannot be explained by mathematical models alone (Gigerenzer, Todd, & ABC Research Group, 1999).

Learning from Disruptive Events

When facing the unexpected, sensemaking becomes difficult, because the existing framework is lost, unusable, or inappropriate to the situation (Weick, 1995). Especially challenging are circumstances or events that are “high-impact, low probability” (Hale, 1997) or what Taleb (2011) called “Black Swans.” While gradual change is the paradigm in finance, history proceeds by jumps, accidents, the unseen, and the unpredicted (Taleb, 2011), which makes the past an unsuitable guide for the future. Perrow (1984) notes that accidents in complex systems are unavoidable because innocent and seemingly unrelated events accumulate and align to create major malfunctions that produce results difficult to comprehend or control. But Cyert, and March (1992) argue that organizations can develop behaviors that help them adapt.

Learning from Failures and Successes

While repeated reliance on successful practices can create competitive advantages (March, 1991), persistence may prove detrimental when the environment changes. Past competence becomes a liability when adaptation to a new situation is needed and the new reality is incompatible with old mental models (Argyris, 1991). Experts are prone to overconfidence when predictability is low and evidence is ambiguous, as in rapidly changing environments (Griffin & Tversky, 1992). Extensive research on overconfidence shows that people attribute successes to their skills, and failures to external events perceived to be outside their control (Odean, 1998). According to Kolb (1984), unexpected events prompt a sense of discomfort and perplexity, which motivates change or stimulates growth. Louis and Sutton (1991) suggested that unexpected, unpleasant, or atypical events trigger hypothesis testing, intensify the attribution process, and stimulate increased sensemaking efforts.

Individual Learning

The revision of old routines involves cognitive elaboration of experiential data (Busby, 1999) and may result in new and significant insights and awareness that can reshape mental models (Friedlander, 1983) and lead to behavioral changes (Huber, 1991). The literature refers to this as reflective learning (Boud, 1985; Boyd & Fales, 1983) or learning from experience (Lewin, 1951; Dewey, 1916). Knowledge is not generated by repeating the same experience several times thereby becoming highly proficient at one behavior, but by reflection during which knowledge is continuously created and re-created and cognitive change results (Kolb, 1984). While highly standardized routines may be efficient under stable conditions (Hannan & Freeman, 1984), they can be dangerous if conditions change unexpectedly (Weick, Sutcliffe, & Obstfeld, 1999).

However, learning from past experiences is subject to interpretation errors and biases (Ariely & Zakay, 2001; March, Sproull & Tamuz, 1991) – such as confirmation bias (Brehmer, 1980; Feldman & March, 1981; Feldman & Pentland, 2003), the tendency to overlook information that is not compatible with a priori assumptions, or hindsight bias (Fischhoff, 1975).

Organizational Learning

Organizations learn through the experiences of members by encoding experiential lessons into organizational norms and routines (Argyris & Schön, 1978; Nystrom, Starbuck, & Hedberg, 1981). The capacity to learn from experience leads firms to gradually adopt routines and strategies that produce favorable outcomes and alternative options (March, 1981). Unfortunately, resulting specialization can lead to a “competency dilemma,” when favorable performance is based on an inferior process (Cooper & Schendel, 1976). If firms do not detect and improve the flaws in the process their competitiveness will be affected, particularly in fast changing environments (Levitt & March, 1988) as demonstrated during the recent crisis by many advisors who exposed clients to excessive risk by building portfolios on unrealistic return assumptions. Sitkin (1992) suggests that when the environment is changing rapidly, organizational focus should be on reliability and resilience to counterbalance a narrow focus on short term performance.

Methods

Design

We conducted a qualitative study using semi-structured interviews to develop a grounded theory (Corbin & Strauss, 2008) about how learning from disruptive events affects financial advisor behavior. A qualitative approach using grounded theory was appropriate for this study as prior

empirical work on financial advisor learning from disruptive events is rare. Grounded theory, an explorative, iterative and cumulative way of building theory (Glaser & Strauss, 1967) involves the constant comparison of data and theoretical sampling (Corbin & Strauss, 2008). Constant comparison is a rigorous method of analysis that involves intensive interaction with the data (Maxwell, 2005) to compare and contrast emerging with already emergent ideas and themes. Simultaneous collection and processing of data (Lincoln & Guba, 1985) lead to the generation of firmly grounded theory. Theoretical sampling refers to ongoing decisions about who to interview next and how. As the constant comparison of data yields insights about phenomena of interest, the sample and the interview protocol are continuously refined.

Sample

Our sample consisted of 30 US financial advisors with at least 10 years of experience in financial planning. Fifteen advisors (50%) worked for national wirehouses, twelve (40%) for the largest independent firms and the remaining 10% were bank advisors. Eighty percent were located in the North East (with 67% in the greater New York area (Manhattan, Long Island, New Jersey) and 13% in Boston), 13% on the West coast (10% in California and 3% in Washington) and 7% in the Midwest, more specifically the metropolitan Chicago area. Most (90%) were male. All advisors were college graduates, the majority with an economics, business or finance degree. Approximately half carried additional finance related designations, such as a CFA, CFP or CFRP (certified financial retirement planner). Respondents were selected initially from the principle researcher's professional network. Thereafter, a snowball technique was adopted to solicit respondents as indicated by themes emerging from the data.

Data Collection

Data was collected between May and July, 2011. The principle research method was semi-structured interviews of approximately 60 minutes duration. Most (22) were conducted in person at or near the advisor's office and the remainder (8) by telephone. All were digitally recorded. Participants were assured of confidentiality. A reputable commercial transcription company transcribed the interviews. The interviews focused on advisor interactions with clients prior to and after the 2008 financial crisis. Following a basic introduction about the research project, we asked a number of open-ended questions. Questions were open-ended to elicit rich and specific narratives and we used probes when needed to clarify and amplify responses. First, informants were invited to talk about themselves, their backgrounds, and their work followed by questions about the most surprising facets of the recent market dislocation. We asked them to describe a recent specific client interaction and explain in detail how they managed the client's money and communicated with him/her. We asked them to then describe a specific meeting with the same client before and after the 2008 financial crisis and to compare and contrast the two experiences in detail. For both instances we used probes to provoke specific information about communication and portfolio construction processes.

Data Analysis

Consistent with a grounded theory approach, data analysis commenced simultaneously with data collection. The audio recordings of each interview were listened to several times and the transcripts of each interview read repeatedly. Three stages of rigorous coding then ensued. First, all transcripts were "open-coded," a process that required the researcher to identify fragments of data with potential interest (commonly called "codable moments" (Boyatzis, 1998). Open coding, which can be compared to a brainstorming process for the analysis of data (Corbin & Strauss, 2008),

requires detailed line-by-line readings of each transcript. These were captured, roughly labeled, and compared to, and categorized with, similar fragments from other interviews. In a second phase of coding ("axial coding") these categories were further redefined as ideas, and themes began to emerge from the data. Finally, in the third phase ("selective coding"), we focused on key categories and themes that then yielded our findings. The analysis involved both manual coding and the use of qualitative data analysis software. Throughout this process, we composed interpretative memos (Maxwell, 2005) and notes reflecting "the mental dialog between the data and the researcher" (Corbin & Strauss, 2008).

Findings

All of the 30 financial advisors in our sample acknowledged the events of 2008 as the most disruptive in their careers in the financial industry. Yet, surprisingly, only six (20%) described the crisis as a "*game changer*" that powerfully influenced their practice. Instead, 80% (24 respondents) described their interaction with, and portfolio management for, clients as fundamentally unchanged from the pre 2008 period. The data revealed five similarities among US financial advisors who persisted in client practices in the aftermath of the 2008 financial market dislocation:

1. Enduring Belief in the Recurrence of Historic Patterns

The majority of advisors in our sample (80%) described the 2008 crisis as the low point of a normal market cycle which they expected would soon revert to equilibrium conditions. These respondents, convinced that "*history always repeats itself*" and "*the same cycle happens over again,*" predicted an eventual market rebound similar to previous, albeit less dramatic, market dislocations. In their view, abruptly changing clients' long term asset allocations would jeopardize the recovery potential of their portfolios once markets reverted to historic means.

Of the six advisors who acknowledged substantially changing their practices, three described the events of 2008 as a "*game changer*" that created "*new market realities.*" These advisors emphasized the importance of continuous – sometimes radical − adaptation to better service clients.

2. Unconditional Belief in Rational Choice Models

Most respondents (80%) stressed the importance of sticking with a routine process and adhering to models based on rational choice assumptions even, they reported, if some of those assumptions might have been violated during the market crisis. These advisors described 2008 as a confluence of rare events during which "*nothing seemed to work.*" One advisor described the situation as "a *perfect storm*" and another as a one-off event unlikely to reoccur: *"…I still tell people we may never see this again in our lifetime. That's how pivotal it was"*. Surprisingly, the severity of the crisis did not dampen advisors' faith in static allocation models and most respondents in the majority group (20 of 24) rationalized 2008 as a mathematically improbable event with no bearing on the future validity of planning models. They also highlighted the importance of maintaining a routine process and keeping clients committed to an agreed upon plan to sustain them in extremely volatile markets. Successful experience with a traditional static approach increased their commitment to it.

The six advisors (20%), who proactively changed their practice, however, described shortcomings in traditional approaches to portfolio management and criticized colleagues who adhered to it. These advisors reported a lack of commitment to the traditional buy and hold approach to investing and admitted they now manage their clients' assets differently. While two of the six revealed that "strategic asset allocation still matters," they described approaching it more

dynamically. They also described the limitations of computer generated allocations based on past empirical data and stressed the danger of relying too much on them.

3. Reframing Time Horizon

Most (26) of our 30 advisors (including two that changed their practice in response to the events of 2008), emphasized the influence of "time horizon" in their advice to clients. Some advisors expressed an unconditional long term view: *"I'm not managing your money for the next 12 months, so if you're down in 12 months, you can call me but I'm gonna say 'so what… I'm managing your money for your lifetime, and I'm trying to basically stop you from you'"*, while a veteran advisor simply stated that: *"…there is no other way"*. Others recognized the shortcomings of their long term approach when it came to responding to unexpected dislocations: *"...I think we tend to manage so much for the long term that it's very difficult for us to make a decision"*. In the absence of an alternative solution, however, staying put and trusting the long term was reported to be the most practical strategy for the majority of advisors. Four advisors alluded to the time horizon with respect to being focused on the present when advising clients, emphasizing the importance of "staying in the moment" and adjusting their planning horizons to those of clients: *"… clients don't have the same timeframe that the model has …"*

4. Cognitive Capacity

All but one of the advisors who did not change practices defined the market dislocation as complex and extremely difficult to deal with*: "…it was overwhelming for everybody"*. An advisor in Westchester described the events as *"paralyzing"* and himself *"being frozen"*. In describing peers' behavior, another remarked: *"…a lot of guys …were absolutely mystified, flummoxed, panicked…"*, which restricted the capacity to learn from the current crisis and reduced adaptive capacity with respect to future crisis.

In contrast, four of the six advisors who changed their practices described efforts to reduce the complexity of the crisis by taking small bets. One described *"just putting (my) toe in the water… and… seeing the way it behaves and learn(ing)."*. Three of the minority advisors stressed the importance of being proactive, as one female advisor on the West Coast stated: *"…this sounds risky, but I would rather be earlier than a little bit later."*

5. Locus of Control

Asked to recall specific recommendations to clients during the crisis, the majority described events as outside of their control. Typically, they reported*"… markets are gonna do what they're gonna do. They're gonna go up, and they're gonna come down,"* and *"there's nothing you (can) do about it"*.

Advisors reported some solace from the fact that they were not alone in their fate and that the majority of financial advisors suffered similarly. *"I mean if it's wrong, then we're not the only ones wrong, I guess is what I would say. But I still would feel confident if everybody around me....is telling me that we're going to be okay...."*

Six advisors didn't delegate responsibility for taking action to somebody else. Among them, three financial advisors were especially explicit in expressing their sole responsibility to protect clients' portfolios. These respondents reported a heightened alertness for, and more proactive scanning of, the environment for clues about how to better position their clients during difficult times. *"I …pay attention to everything"*.

Discussion

We wondered how and to what extent the 2008 crisis impacted the professional behavior of US financial advisors, what they learned from it, and how it affected their portfolio construction practices. All advisors in our sample were deeply shaken by the events of 2008 and struggled to make sense of them. They described a tension between reliance on financial models that had been a mainstay for decades and evidence of their potential obsolescence.

According to Festinger's Theory of Cognitive Dissonance (1957), holding conflicting views of the world causes discomfort which may be reduced by changing one's attitudes and beliefs, blaming others, or denial. The majority of our sample adopted the latter responses, framing the events of 2008 as a statistical anomaly that did not dictate change. By choosing to understand the 2008 crisis as a recurrence of historic patterns or market cycles and assuming that the market would eventually "heal itself," these advisors could justify adhering to practices that had yielded successful results in the past – a behavior we refer to as "collective adherence". Furthermore, the overwhelming complexity of the crisis "froze" many advisors, caused them to rely on "powerful others" to resolve it, or they took comfort in the view that their peers were equally challenged by the unfolding events. They sought shelter from this threatening environment in group cohesion, a reaction we label "collective uniformity."

Collective Adherence

Dane (2010) proposes that inflexibility arises most directly, not from expertise, but from cognitive entrenchment – a high level of stability in one's domain schemas. Stable schemas predispose individuals to respond consistently and, thus, reduce their adaptability to a novel situation. Experts can escape entrenchment by engaging in a dynamic environment. While we found strong cognitive adherence among financial advisors, we did not find evidence that exposure to a dynamic environment (which the financial market unquestionably is) reduced entrenchment. On the contrary, we observed an active and collective resistance to change the more dynamic the environment became. "Collective adherence" manifested in active defenses of long held assumptions that had historically been effective. We identified three distinct beliefs; a) the enduring belief in the recurrence of historic patterns, b) the unconditional belief in rational choice models and c) the belief that extending the time horizon always delivers the right results.

1. Enduring Belief in the Recurrence of Historic Patterns

Portfolios are traditionally built on a mean/variance optimization framework (Markowitz, 1952) which assumes that outcomes are normally distributed around a historically observed mean. A fundamental assumption of this model is that returns oscillate around that mean and create somewhat predictable patterns. Our data revealed most advisors strongly believe in these patterns or cycles and in the notion of mean reversion. This is not surprising as there has been little in the last 30 years to challenge this consensus view of generally benign markets interrupted only by relatively brief and isolated downturns (Black Monday, 1987; Emerging Markets Debt Crisis, 1993/94; Asian Crisis, 1997/98; Technology Bubble, 2000/01; Sub-prime Mortgage Crisis, 2008). These sharp corrections could have served as warning signs, but strong rebounds repeatedly reinforced advisors' beliefs that staying the course was ultimately the best strategy. Passivity was rewarded as the market eventually reverted to its mean, bailed out underperforming portfolios and, as a consequence, no adaptation or learning was deemed necessary.

As Nystrom, Starbuck, and Hedberg (1981) observed, managers often do not respond to environmental signals that suggest the need for strategic change. Similarly, our respondents failed to

significantly change their portfolio construction approach. Baumard & Starbuck (2005) propose that "events that appear rare to academic observers likely appear unique to learners, and uniqueness impedes learning." A catastrophic crisis is, by definition, a unique event and thus any learning from it is likely to be considered neither relevant nor applicable in other settings (Wilkinson & Ramirez, 2010). In the aftermath of the 2008 crisis, our advisors preferred to focus on historically successful outcomes, rely on simplistic assumptions, and steadfastly repeat standard processes to determine clients' optimal portfolio allocations.

2. Unconditional Belief in Rational Choice Models

Research suggests past success inhibits learning and adaptation (March, 1991; Levinthal & March, 1993). The emergence of standardized asset allocation software some 20 years ago made the construction and monitoring of portfolios very efficient and the static "buy and hold" approach delivered impressive results during the secular bull market of 1982-2006. However, successes do not create an urgent need to revise existing knowledge as they confirm prior expectations (Cyert & March, 1992; Weiner, 1985, 2000), increase confidence in old routines (Daft & Weick, 1984; Audia, Locke, & Smith, 2000) and discourage cognitive activity associated with immediate change (Sitkin, 1992). Our findings strongly suggest that advisors' success and institutional memory blinded them from the need to change their models. The very factors that facilitated their success may have handicapped their responsiveness and agility under changing circumstances (Christensen, 1997).

When probed, most of our respondents stated a strong commitment to the context free classical decision making (CDM) approach assuming full rationality of their environment. Only a few acknowledged that those assumptions were violated during the crisis and that a more "contextual" approach was necessary. While not specifically mentioned, Naturalistic Decision Making (NDM; Klein, Orasanu, Calderwood, & Zsambok, 1993) seems prevalent with the more resilient advisors as they adapt quickly to changing circumstances. However, most of our respondents continued, post-2008, to believe in and allocate clients' assets according to static buy and hold strategies – a seemingly classic example of belief perseverance (Ross, Lepper, & Hubbard, 1975). Our data suggest that the longer an advisor has used static allocation models successfully, the more he/she believes in their merit under almost any market scenario. According to Staw (1976; Staw, Sandelands, & Dutton, 1981), this results in escalation of commitment, the bias to commit resources to justify previous actions whether or not the rationale for the initial commitments remains valid.

3. Reframing the Time Horizon.

Prospect theory distinguishes two phases in the choice process: a phase of framing and editing, followed by a phase of evaluation (Kahneman & Tversky, 1979). The first consists of a preliminary analysis of the decision problem which frames effective acts, contingencies, and outcomes. Framing is controlled by the manner in which the choice problem is presented, as well as by norms, habits, and expectancies of the decision maker. Many of our respondents framed the market dislocation as a short term "glitch" that appeared less significant if the time horizon was conveniently extended, which, in turn, reduced the need for immediate action. Such behavior might be described as "procrastination," which occurs when current costs are more salient than future costs, leading individuals to postpone tasks (Akerlof, 1991). This salience can lead to systematic distortion of individual perception and interfere with the process of rational utility maximization.

Collective Uniformity

According to Festinger (1950) stronger group cohesiveness develops during turbulent times as members perceive uniformity as necessary for survival. Turbulent times might be understood as accidents in complex systems (Perrow, 1984) that are unavoidable and impossible to anticipate because of our limited ability to comprehend what is transpiring and our lack of control over it.

We saw vibrant evidence of both of these phenomena in our data. Financial advisors admitted to limited comprehension of, and lack of control during, the crisis. As Simon (1956) explained, decision makers are limited by their values and unconscious reflexes, skills, and habits and, therefore, cannot envision all the alternatives available to them (Gavetti & Levinthal, 2000). Few advisors endeavored to learn through active intervention (enactment) and to test existing rules and precedents (Choo, 2002; Weick, 1995). Most demonstrated "threat rigidity" described by Staw et al. (1981) as the tendency to respond to states of stress and anxiety with reliance on prior expectations and well-learned responses. This means that even with increased search, information received would likely be similar to that of the past, resulting in little learning and adaptation (Starbuck, Greve, & Hedberg, 1979).

Finally, our data revealed strong evidence that advisors sought one another's guidance and advice during the financial crisis *"We can be here together, and… (provide)… a sense of stability"*. The downside of group cohesiveness is groupthink which occurs when a group's desire for harmony overrides a realistic appraisal of alternatives (Janis, 1972). This tendency toward harmony led to homogenous advisor behavior leaving clients with little choice but to stay with their existing advisor as the marginal difference between advisors was slight.

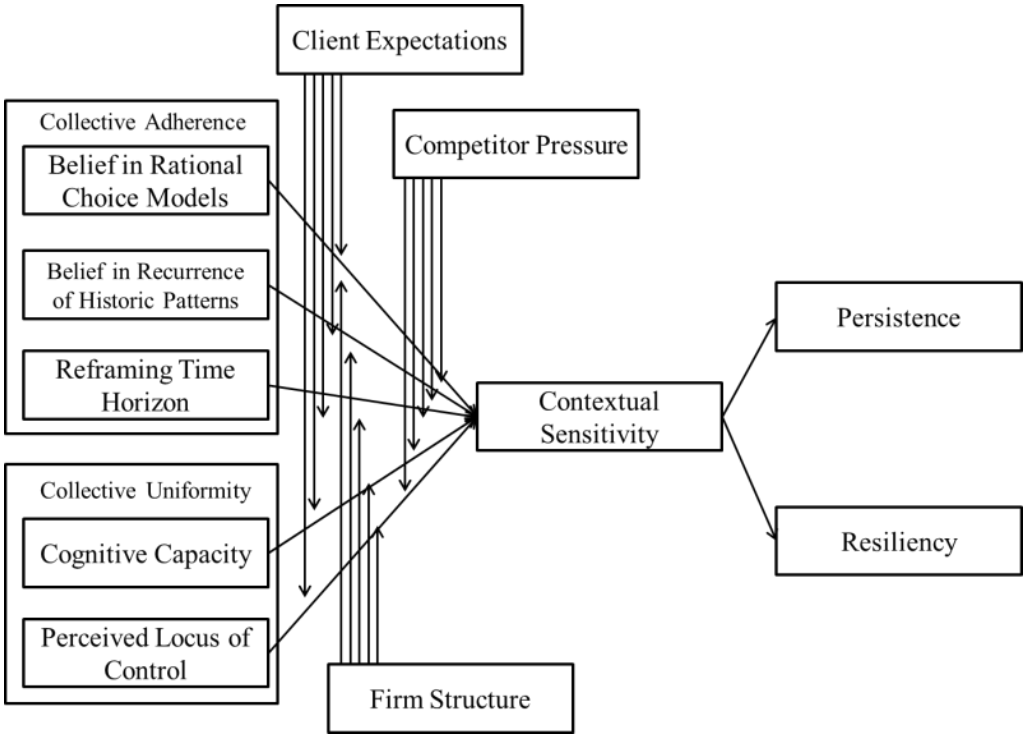
Contextual Sensitivity

Our findings are reflected in the conceptual model presented in Figure 1. The model suggests financial advisor persistence to adhere to old routines or resilience to adjust to adverse market conditions is influenced by "contextual sensitivity." Contextual sensitivity reflects how strongly an advisor is committed to, and believes in, the traditional portfolio construction process and the recurrence of historic patterns. Time horizon management, ability to grasp unfolding developments and perceived degree of control affect contextual sensitivity. These relationships may be moderated by client expectations, competitor pressures or structural factors.

Limitations

Our findings should be considered in light of several limitations that may impact their generalizability. Our sample, while considered appropriate for a grounded theory inquiry, was small (n=30) and concentrated in the North East of the United States. The sample captures the gender distribution of the financial advisor population in the US fairly accurately (approx. 10% female advisors), however, our sample does not include diversity in terms of race or experience, as all our respondents were Caucasian and had at least 10 years of experience While a purposeful effort was made to minimize researcher bias, we acknowledge that the principle researcher's 25 years of experience as an investment management executive may have influenced how data was collected, analyzed and interpreted.

Figure 1: Conceptual Model



Implications for Practice and Future Research

We recognize many opportunities for further research on how learning from disruptive market events affects financial advisor behavior. Empirical validation of the conceptual models is recommended. While our research revealed five factors influencing advisor contextual sensitivity to market jolts, investigation of additional factors is desirable. Conducting similar research on a global basis might deliver exciting insights into cultural and geographic differences in advisor behavior. Also, a longitudinal study of advisor behavior over multiple market cycles might reveal new insights. Exploration of behavioral differences related to gender is also recommended as an additional avenue for future research.

Our findings should be of interest to the financial advisor community and its clients and around the world. While there is ample research on optimal behavior under normal market circumstances and some of the behavioral pitfalls faced by professional and private investors when making decisions under uncertainty, there is scant research with respect to financial intermediaries and the particular challenges they face. Our findings might help employers in selecting, evaluating and training advisors for what may well be a very different investing environment in the future. Finally, our results may be of interest to clients, enabling conversations with their advisors about the portfolio construction process and appropriate responses to future unexpected market events.

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English Abstract

Learning from Disruptive Market Events

A Study of Financial Advisor Behavior

Philipp A. Hensler*, Tony Lingham, Sheri Perelli

Case Western Reserve University
philipphensler@mac.com

Abstract

The static portfolio construction process, while an efficient, rational and stunningly successful strategy for allocating client assets in well behaved markets, may prove less so in disruptive markets when active financial advisor intervention may be necessary. The literature is silent about how financial advisors learn from market dislocations and how market dislocations affect their asset allocation practices. Semi-structured interviews with 30 senior US financial advisors yielded insights about their allocation decisions prior to and after the 2008 financial crisis. Post crisis persistence in beliefs and behaviors are attributable to an enduring belief in recurring historic patterns, unwavering reliance on traditional model assumptions and active time horizon management. Furthermore, striking differences in cognitive capacity and perceived locus of control distinguish the post-2008 practice of most financial advisors from the relatively few who have adopted more dynamic portfolio management approaches.

Findings should be of interest not only to financial industry professionals but to the clients who rely on their advice.

Keywords: Financial crisis, financial advisors, disruptive event, individual learning, organizational learning

French Abstract*

Learning from Disruptive Market Events: A Study of Financial Advisor Behavior

Apprentissage et événements de marché disruptifs

Une étude du comportement du conseiller financier

Philipp A. Hensler*, Tony Lingham, Sheri Perelli

Case Western Reserve University
philipphensler@mac.com

Résumé

Le processus de construction d'un portefeuille statique par une stratégie efficace, rationnelle et réussie d'allocation des actifs de clients, dans des marchés qui fonctionnent bien, peut s'avérer moins réussi dans des marchés disruptifs, qui nécessitent l'intervention active d'un conseiller financier. La littérature est muette sur la façon dont les conseillers financiers apprennent des disruptions du marché et comment celles-ci influent sur leurs pratiques en matière d'allocation d'actifs. Des entretiens semi-structurés avec 30 conseillers financiers séniors américains donnent un aperçu de leurs décisions d'affectation avant et après la crise financière de 2008. La persistance des croyances et comportements post- crise sont attribuables à une croyance durable de la reproduction des schémas historiques et l'inébranlable confiance dans les hypothèses des modèles traditionnels de la gestion active de l'horizon temporel. En outre, des différences frappantes dans la capacité cognitive et le locus du contrôle perçu distinguent la pratique postérieure à 2008 de la plupart des conseillers financiers de ceux, relativement rares, qui ont adopté des approches plus dynamiques de la gestion de portefeuille. Les résultats devraient intéresser non seulement les professionnels de l'industrie financière, mais aussi les clients qui comptent sur leurs conseils.

Mots-clés: crise financière, conseillers financiers, un événement disruptif, l'apprentissage individuel, l'apprentissage organisationnel

* Translated by: Johannes Schaaper, Senior professor in International Management, BEM Bordeaux Management School

German Abstract*

Learning from Disruptive Market Events: A Study of Financial Advisor Behavior

Lernen aus krisenhaften Marktereignissen

Eine Studie über das Verhalten von Finanzberatern

Philipp A. Hensler*, Tony Lingham, Sheri Perelli
Case Western Reserve University
philipphensler@mac.com

Zusammenfassung

Der statische Portfoliokonstruktionsprozess, der eine effiziente, rationale und überaus erfolgreiche Allokationsstrategie für Kundenvermögenswerte innerhalb gut funktionierender Märkte darstellt, kann sich hingegen in unbeständigen Märkten als weniger erfolgreich erweisen, insofern dort ein aktiver Eingriff eines Finanzberaters erforderlich ist. In der Literatur findet man nur wenige Hinweis darauf, wie Finanzberater aus Marktverwerfungen lernen und wie diese Marktverwerfungen ihre Vermögensallokation beeinflussen. Semi-strukturierte Interviews mit 30 Senior US-Finanzberatern sollen nun einen Einblick in die Allokationsentscheidungsprozesse vor sowie nach der Finanzkrise im Jahr 2008 geben. Der Glaube und das Verhalten nach der Krise sind von dem Glauben an das Wiederholen historischer Muster geprägt, genauso wie das unerschütterliche Vertrauen in traditionelle Modellannahmen und das strategische Management von Zeithorizonten. Seit der Finanzkrise sind zudem entscheidende Unterschiede hinsichtlich der kognitiven Fähigkeiten und der wahrgenommenen Kontrollüberzeugung der Finanzberater zu erkennen, zumal ihre Berufspraktiken sich heute zunehmend an einem dynamischen Portfoliomanagement orientieren.

Die Ergebnisse der Studie sind nicht nur für den Berufsstand der Finanzberater von Bedeutung, sondern auch für die Mandanten die von ihnen beraten werden.

Stichwörter: Finanzkrise, Finanzberater, krisenhaftes Ereignis, individuelles Lernen, organisatorisches Lernen

* Translated by: Prof. Dr. Marc Eulerich, University Duisburg-Essen, marc.eulerich@uni-due.de

Spanish Abstract*

Learning from Disruptive Market Events: A Study of Financial Advisor Behavior

Aprendiendo de Sucesos de Mercado Perturbadores

Un Estudio del Comportamiento Asesor Financiero

Philipp A. Hensler*, Tony Lingham, Sheri Perelli
Case Western Reserve University
philipphensler@mac.com

Resumen

En el proceso de construcción de la cartera estática, mientras que una estrategia eficiente, racional y sorprendentemente exitosa para la asignación de activos de los clientes en los mercados de buen comportamiento, puede resultar mucho menos exitosa en los mercados perturbadores cuando es necesaria la intervención del asesor financiero activo. La literatura no dice nada acerca de cómo los asesores financieros aprenden de trastornos del mercado y cómo las perturbaciones del mercado afectan sus prácticas de asignación de activos. Se llevaron a cabo entrevistas semi-estructuradas con 30 altos asesores financieros de Estados Unidos que dieron ideas sobre sus decisiones de asignación de antes y después de la crisis financiera de 2008. La persistencia en las creencias y los comportamientos después de la crisis son atribuibles a una tendencia perdurable en repetir los patrones históricos, a una inquebrantable confianza en los supuestos del modelo tradicional y a la gestión activa del horizonte temporal. Por otra parte, se observan grandes diferencias en la capacidad cognitiva y el lugar de control percibido en la práctica post-2008 de la mayoría de los asesores financieros, de los relativamente pocos que han adoptado enfoques de gestión de carteras más dinámicas.

Los resultados deben ser de interés no sólo para los profesionales del sector financiero, sino también para los clientes que confían en sus consejos.

Palabras clave: crisis financiera, asesores financieros, evento perturbador, aprendizaje individual, aprendizaje organizacional.

* Translated by: Francis Blasco. Universidad Complutense de Madrid. fblasco@emp.ucm.es

Arabic Abstract*

Learning from Disruptive Market Events: A Study of Financial Advisor Behavior

التعلم من أحداث السوق التخريبية:
دراسة حول سلوك القطاع المالي

Philipp A. Hensler*, Tony Lingham, Sheri Perelli
Case Western Reserve University
philipphensler@mac.com

ملخص

ان عملية انشاء المحفظة المالية الساكنة بالرغم من كونها ناجعة, عقلانية, و استراتيجية ناجحة في توزيع أصول العملاء في أسواق مربحة الا أنها لا تتسم بهذه الصفات الايجابية في الاسواق التخريبية حيث يكون هنالك حاجة ماسة لتدخل المستشارين الماليين, الأدبيات السابقة لا تذكر كيف يتعلم المستشارين الماليين من سوء توزيع الأسواق و من كيفية تأثير هذه الوزيعات السوقية على ممارسات توزيعات الأصول.

تم اجراء ثلاثين مقابلة شبه هيكلية مع كبار المستشارين الماليين في الولايات المتحدة الأميركية حيث تم سبر أغوار آلية توزيعهم للأصول قبل و بعد الأزمة المالية عام 2008 .

تم أكتشاف أن ثبات معتقدات و سلوكيات الاخبراء الماليين بعد أزمة 2008 تعزى الى ايمانهم المطلق بأن التاريخ يعيد نفسه أي أن هنالك انماط متكررة عبر الزمن و ايضا اعتمادهم على النماذج التقليدية و ادارتهم للأفق الزمني للاستثمارات بشكل فعال. و أيضا خلصت الدراسة أن هنالك فروقات واضحة بين القدرة الأدراكية و تمركز السيطرة بعد أزمة 2008 من العدد القليل من الخبراء الماليين الذين تبنو طرق دينميكية و أكثر حداثة لادارة المحافظ, هذه النتائج ذات قيمة للمهنيين في القطاع الملي و ايضا للعملاء الذين يعتمدون على نصائهم.

الكلمات الدالة: الأزمة المالية, المستشارين الماليين, الأحداث التخريبية, التعلم الفردي, التعلم التنظيمي

* Translated by: Zu'bi M.F.Al-Zu'bi, Ph.D, FHEA, University of Jordan, z.alzubi@ju.edu.jo

Italian Abstract*

Learning from Disruptive Market Events: A Study of Financial Advisor Behavior

Apprendere da mercati colpiti da cambiamenti dirompenti

Uno studio sul comportamento di consulenza finanziaria

Philipp A. Hensler*, Tony Lingham, Sheri Perelli

Case Western Reserve University
philipphensler@mac.com

Abstract

La costruzione di un portfolio statico, efficiente, razionale e con una strategia di successo per allocare gli asset di clienti in mercati che hanno un buon comportamento, può essere meno efficace quando l'intervento attivo di un consulente finanziario é necessario. Facendo colloqui semi strutturati con 30 consulenti finanziari senior negli USA ha dato degli spunti importanti su come cambiamenti dirompenti sul mercato abbiano un impatto sul loro modo di allocare le risorse prima e dopo la crisi finanziaria del 2008. La persistenza di convinzioni e comportamenti post crisi sono attribuibili a convinzioni ricorrenti dal passato, alleanze che persistono, il continuare della dipendenza su convenzioni riguardanti modelli tradizionali e una gestione attiva degli orizzonti temporali. Inoltre, marcate differenze in capacità cognitive e percepiti fulcri di controllo, distinguono le pratiche post 2008 della maggior parte dei consulenti finanziari rispetto a pochi che hanno adottato una gestione di portfolio più dinamica. Le conclusioni dovrebbero essere di interesse non solo per i professionisti del settore, ma anche per i loro clienti che dipendono dai loro consigli.

Keywords: Crisi finanzia, Consulenti Finanziari, Eventi Dirompenti di Cambiamento, Apprendimento Individuale, Apprendimento organizzativo

* Translated by: Riccardo Paterni, Synergy Pathways, riccardo@synergypathways.net