NAVIGATING YOUR WAY THROUGH A CRISIS

Jose Vilchez & George Lagarias
May 2020

AREAS THAT WILL BE COVERED

- Financial Planning Housekeeping – time to get financially "fit"
- Lifetime Cashflow Modelling – are you "on track" to meet your goals?
- Behaviour – An Introduction

FINANCIAL PLANNING HOUSEKEEPING

1. Emergency budget
2. Establish your entitlements
3. Review insurance
4. Debt repayment options
5. Cash deposits
6. Pensions
7. Wills, Lasting Powers of Attorney

FINANCIAL PLANNING HOUSEKEEPING

- Emergency Budget
  - Calculate reduced net income
  - Addressing shortfalls – depleting reserves, reduce commitments
- Establish your entitlements
  - Support from government/employer

FINANCIAL PLANNING HOUSEKEEPING

- Review Insurance
  - Check for potential pay-out on income protection, mortgage repayment protection, payment protection insurance
  - Difficulty in underwriting new cover
- Cash deposits
  - Financial Services Compensation Scheme (FSCS) Protection
  - National Savings & Investments
  - Access on term deposits

FINANCIAL PLANNING HOUSEKEEPING

- Debt Repayment
  - Speak to creditors
  - Payment freeze of up to 3 months on many debt arrangements
- Pensions
  - State Pension Forecast, find pension contact details – Gov.uk
  - Beware of scams
- Wills and Lasting Powers of Attorney

COVID-19 INITIATIVES

- Support for individuals
  - Coronavirus Job Retention Scheme
  - Self-Employed Income Support Scheme
  - Mortgage repayment holiday
  - State Benefits – Universal Credit, Statutory Sick Pay, Employment and Support Allowance
  - HMRC 'Time to Pay', deferral of self-assessment tax until Jan 2021

STAYING FOCUSSED ON THE LONG TERM

- Increasing life expectancy and average time in retirement
- Ensure that short-term provision is in place
- Prioritise your goals
- Determine your attitude to risk and capacity for loss
- Invest over the long-term (5 years +)
- Diversify your investments

LIFETIME CASHFLOW MODELLING

Jose Vilchez
May 2020

MAZARS

PRINCIPLES OF LIFETIME CASHFLOW MODELLING

FINANCIAL POSITION TODAY

Helps assess your clients current overall financial position

IDENTIFIES GOALS

The cashflow modelling process enables you to clearly identify your clients financial goals over their lifetime

VISUAL

Provides a visual representation of an individuals finances over lifetime

ACTION PLAN

Aids with the creation of an action plan

REVIEW

Provides a framework to manage finances which should then be reviewed on a regular basis

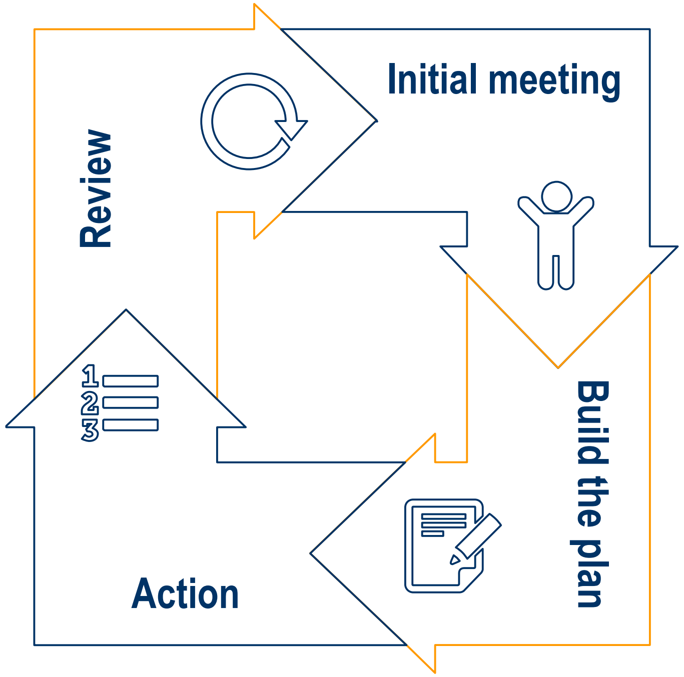
CASHFLOW MODELLING – THE CLIENT JOURNEY

REVIEW

It is important to review the financial plan on a regular basis (at least annually) to ensure that remain on track to achieve financial goals

AGREE KEY ACTION POINTS & IMPLEMENT

From the plan we create a clear summary of the actions that need to be taken



INITIAL MEETING

The purpose of the initial meeting is to understand current financial position (assets /liabilities, income/expenditure) and goals over an individuals lifetime

BUILD THE PLAN

Having identified your clients current financial position and goals, we work with them to model different scenarios to then be able to identify the most appropriate financial plan to meet

CASE STUDY – SIMON & SALLY DAY

- Both aged 62, looking to retire at age 65
- Income/Assets

Income	Value
Pre 65 earned income	£177,000 joint
Post 65 pension income	£32,500

Asset	Value
Simon DC Pensions	£340,000
Sally DC Pensions	£100,000
Simon Investment ISA	£120,000
Sally Investment ISA	£140,000

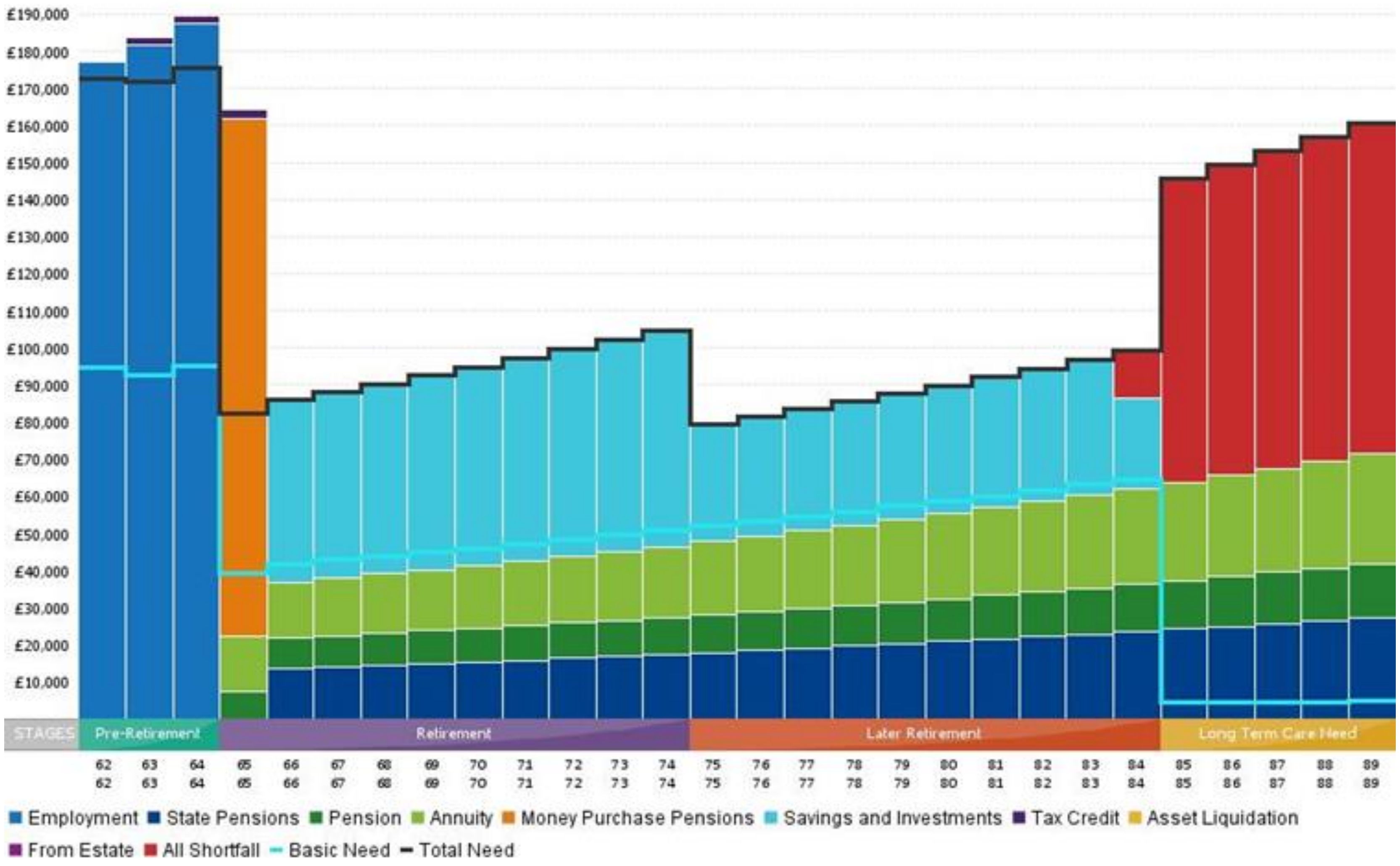
- Expenditure £75,000 p.a. to age 75, £55,000 to age 85, £80,000 to age 90 – all values in today's terms

CASE STUDY – SIMON & SALLY DAY

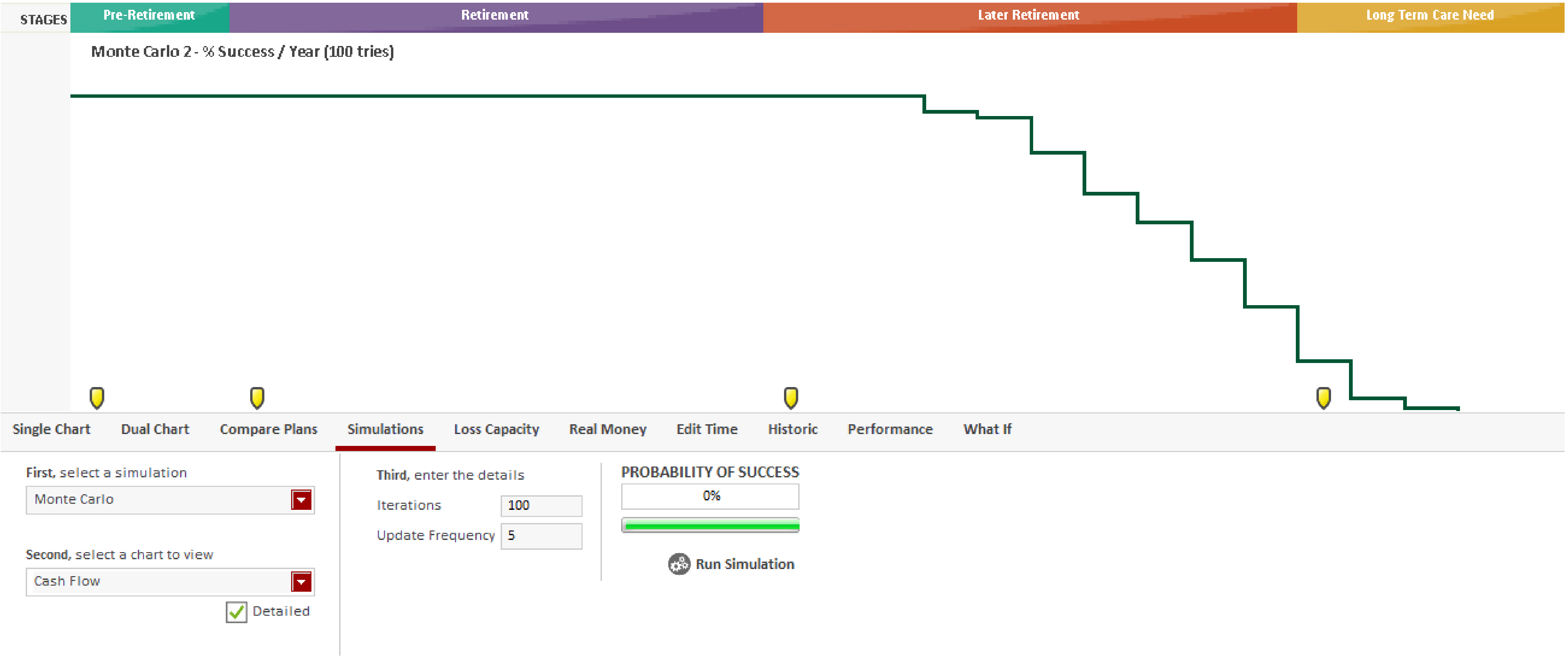
- Key Assumptions

Mortality Age	90
Rate of Inflation	2.50% p.a.
Interest on Cash Assets	1.50% p.a.
Investment Growth on Pension/ISA Holdings	3.50% p.a. (net of costs)
Property Growth	

CASE STUDY – SIMON & SALLY DAY

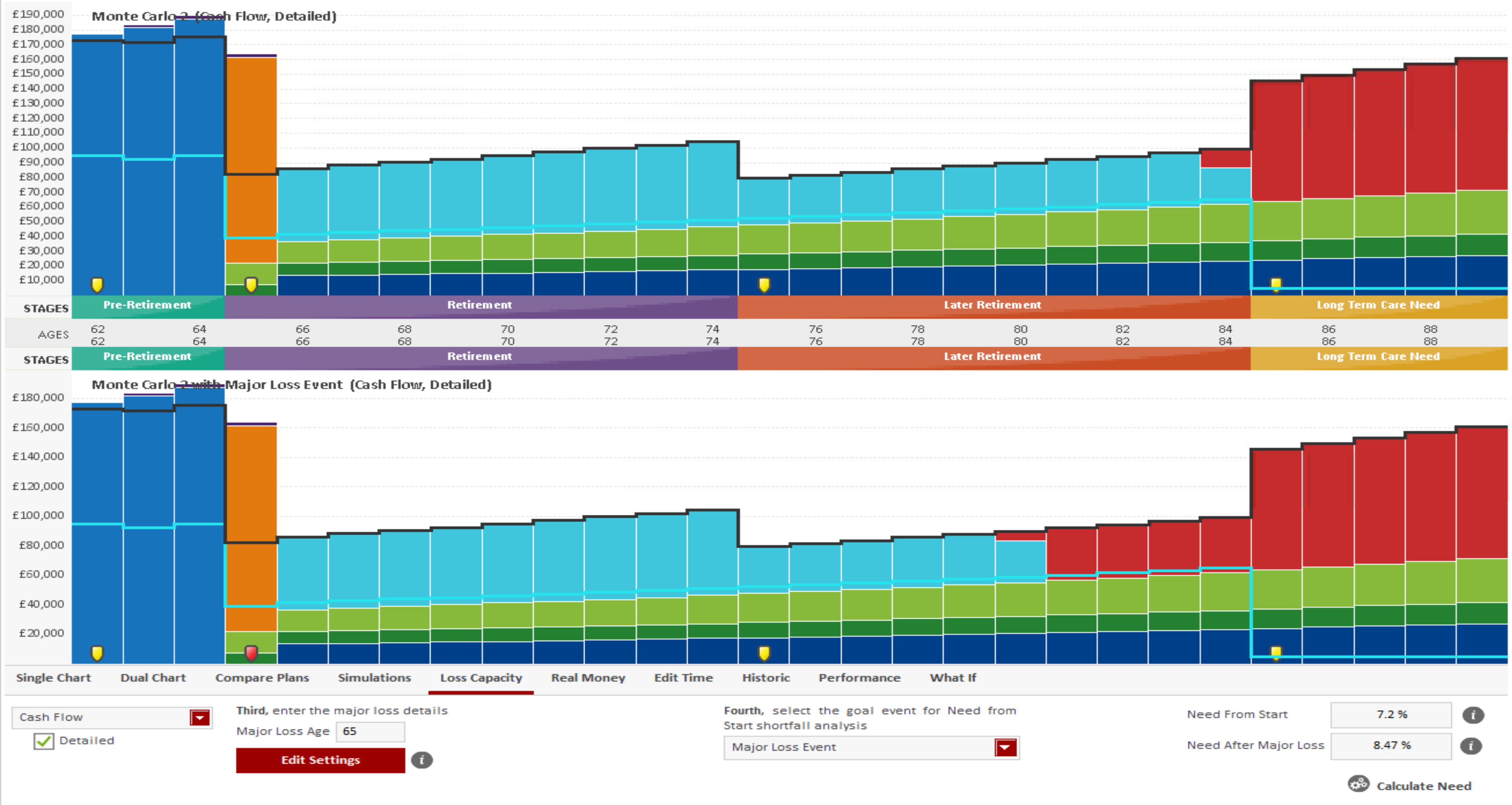


MONTE CARLO SIMULATION



MAZARS

MODELLING LOSS EVENTS



MAZARS

CASHFLOW MODELLING OUTPUT

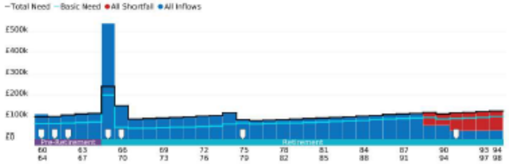
Financial Summary

The Financial Summary report provides you with an overview of your plan assumptions and key projections, including Cash Flow, Net Worth, and Asset Allocation. In addition, it provides Insights into achieving your goals. It indicates the state of your current financial health.

John Smith
Current Age: **60**
Retirement Age: **65**

Jane Smith
Current Age: **64**
Retirement Age: **65**

Cash Flow



Goal Summary (first 3)

Pre-Retirement Expenditure (Basic Needs)	100%
Retirement Expenditure (Basic)	84%
Pre-Retirement Expenditure (Discretionary)	100%

Insights

Annual Savings Need

Save an additional **£29,883** annually until retirement to meet your goal.

Investment Returns

A **5.3 %** return is needed annually to prevent shortfall.

Retirement Spending

You can afford to spend **£52,148** annually in retirement with your current plan. This amount is after taxes.

Lump Sum Savings

A lump sum of **£199,219** would be needed at retirement to prevent shortfall.

Net Worth

£2,020,000

Assets: £2,160,000
Debts: £140,000

Assumptions

Inflation Rate: 3.0 %
Cash Growth: 2.0 %
Investment Growth: 4.0 %
Income Growth: 3.0 %
Property Growth: 3.0 %

Asset Allocation

Savings	1%
Investments	5%
Pensions	16%
Non-Liquid	78%

MAZARS

BENEFITS OF CASHFLOW MODELLING

- Brings clarity to personal finances
- Helps to identify financial goals over lifetime
- Provides visual representation of financial position
- Enables informed financial decisions to be made
- **Free initial consultation and lifetime model for ICAEW members**

BEHAVIOUR - DON’T PANIC!

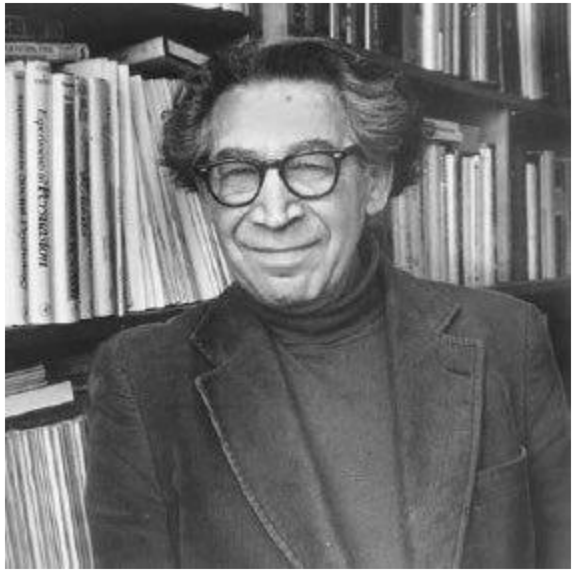
George Lagarias
May 2020

MAZARS

COGNITIVE THEORY

- Cognition: the mental action or process of acquiring knowledge and understanding through thought, experience, and the senses.
- How we respond to cognitive changes is a process of steps, rather than response to one single stimulus.
- Cognitive Dissonance is key to understanding cognition. It is the brain's discomfort to a new stimulus, which leads it to search for shortcuts and/or alternatives. (Festinger, 1957).

PEOPLE TO KNOW



Leon Festinger: 1919-1989

Festinger is the father of cognitive dissonance. He infiltrated a doomsday cult in the 60's to explain how convictions are created.

Solomon Asch: 1907-1996

Run the most famous series of experiments to explain conformity

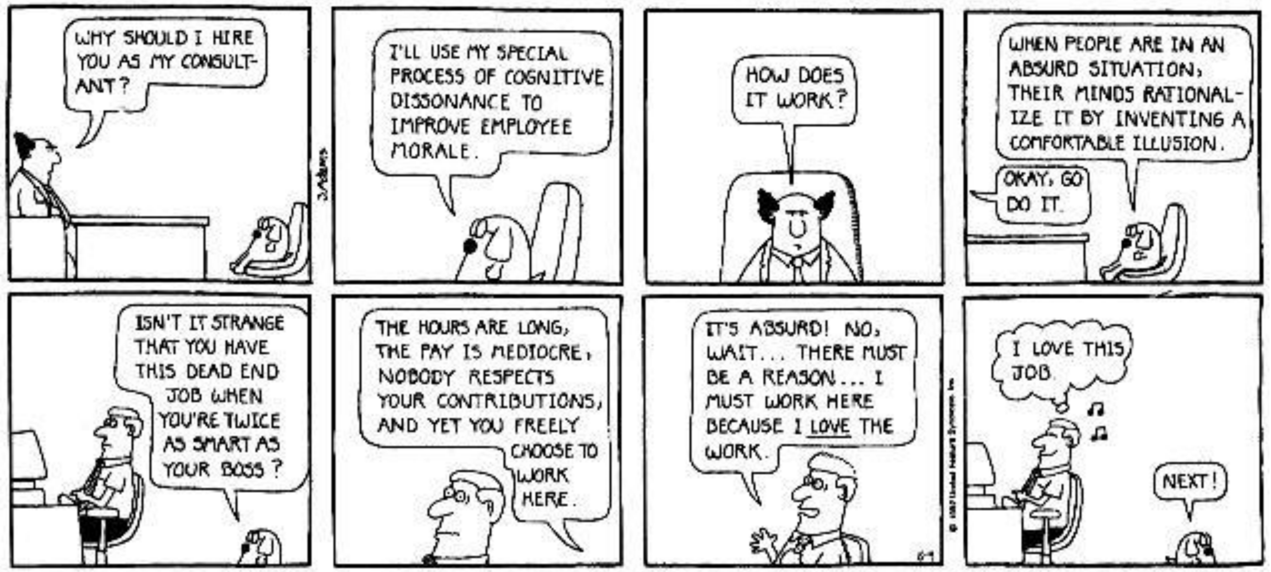
Robert Cialdini: 1945-today

Wrote the book "Influence" an explanation of why and how we are persuaded to do things in everyday life

MAZARS

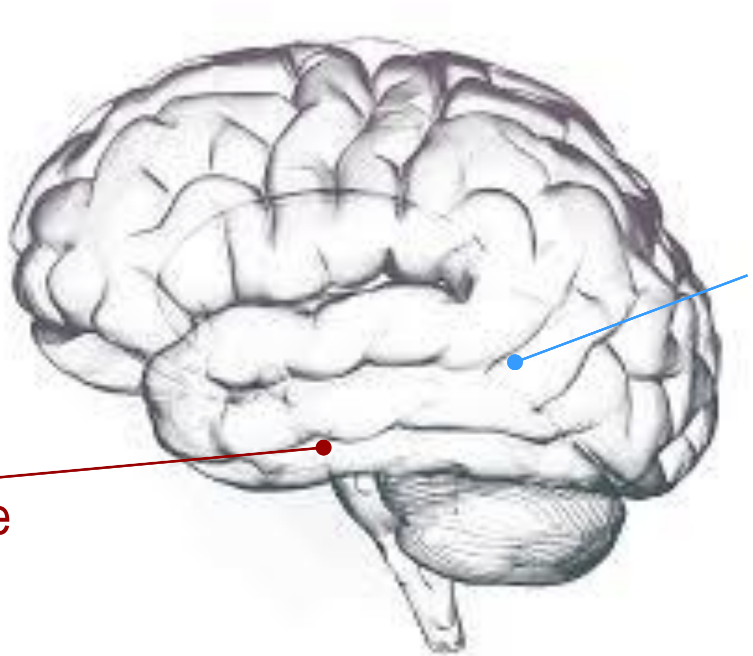
COGNITIVE DISSONANCE

- Leon Festinger: “When a person holds two cognitions that are psychologically inconsistence, they would experience dissonance and would attempt to reduce it, much like one would attempt to reduce hunger or thirst.”
- Most people strive for a consistent and morally pleasing view of themselves
- The brain tries to avoid difficult tasks or information that conflict with its world view
- The discomfort often leads to Heuristics (rules of the thumb) which help us deal with everyday problems
- From Heuristics, Biases are created, which are essentially repeated heuristics that have worked in the past
- The best form of conviction, is convincing ourselves. Cognitive dissonance provides the mechanism.



(Writer's note: I-LOVE-DILBERT!)

I AM OF TWO MINDS: BENEFITS AND COSTS



Basal Ganglia and Dopaminergic Fibers

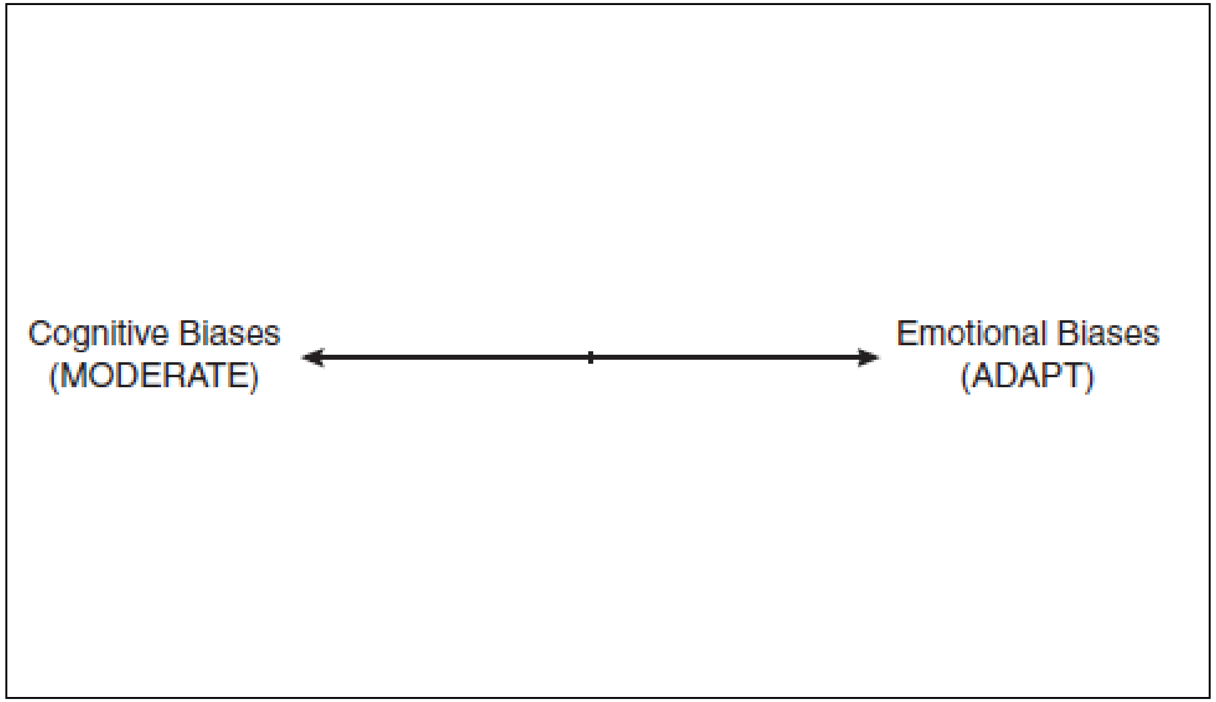
Sensitive to and activate action to obtain benefits and rewards

Amygdala and Serotonin Receptors

Sensitive to punishment and absence of rewards

- Failure to avoid costs produces agitation and anger
- Failure to obtain benefits produces dejection, sadness.

THE BEHAVIOURAL ASPECT



Journal of Financial Planning

MAIN BEHAVIOURAL BIASES

Cognitive

- Overconfidence
- Representativeness
- Anchoring
- Cognitive Dissonance
- Ambiguity Aversion
- Availability
- Self – Attribution
- Illusion of control
- Conservatism
- Optimism

Emotional

- Endowment
- Mental Accounting
- Confirmation
- Hindsight
- Loss Aversion
- Regret Aversion
- Recency
- Framing
- Status Quo

OVERCONFIDENCE *(COGNITIVE)*

Description: Unwarranted faith in one's intuitive reasoning, judgments and cognitive abilities. People are poorly calibrated in estimating probabilities—events they think are certain to happen are often far less than 100 % to occur.

Example: Investors may get a *tip from a financial advisor* or read something on the Internet, and then they're ready to take action. Overconfident investors will overestimate returns and underestimate potential losses.

Behaviour: Unfounded belief in investment returns, excessive trading, underestimating downside, under-diversification, not adequate financial planning.

Advisers can discuss historic upside / downside of portfolios and single stocks. Use "Fundamentals of Investment" document (p2) to discuss probabilities of market going up and down.

REPRESENTATIVENESS *(COGNITIVE)*

Description: Classifying a new object/ investment /situation into an existing broad category, which may not exactly fit the risk/reward profile. Investors ignore the statistically dominant result in order to satisfy their need for patterns

Base-Rate Neglect. Determine the potential success of investment in Company A by contextualizing the venture in a familiar, easy-to-understand classification ("this is a *value* investment therefore I don't expect volatility)

Sample-Size Neglect. In sample-size neglect, investors, when judging the likelihood of a particular investment outcome, often fail to accurately consider the sample size of the data. They incorrectly assume that small sample sizes are *representative* of populations (or "real" data).

Consequences: Closemindedness, false expectations, misjudging investments. Investing on past few quarters or few recommendations, chasing returns.

What advisers should do: Base rate: make sure investments are not mis-framed, and show true history of returns (FOI p2)
Sample Size: Don't "sell returns", rather focus on broad benefits of asset allocation (FOI p9)

MAZARS

ANCHORING BIAS *(COGNITIVE)*

Description: When required to estimate a value with unknown magnitude, people generally begin by envisioning some initial, default number—an "anchor"—which they then adjust up or down.

Example: An investor might be reluctant to sell their property for £400K if it had been valued at £450K 3 years ago. But they may fail to assess that due to a market downturn it may go even further below for the foreseeable future. An investor might be reluctant to invest in a portfolio because the market is at "all time highs". They may fail to assess that the market could go even further.

Consequences: Reluctance changing the status quo (selling or investing), misconception of "expensive" or "cheap market".

What advisers should do: Always indicate to clients that there are peaks and troughs, and there could be a long space between them. Anchoring to a particular value does not mean that this value will definitely repeat itself soon. (FOI P. 14)

AMBIGUITY AVERSION BIAS *(COGNITIVE)*

Description: People hesitate in situations of uncertainty or ambiguity. In financial markets, people often make decisions on subjective probabilities.

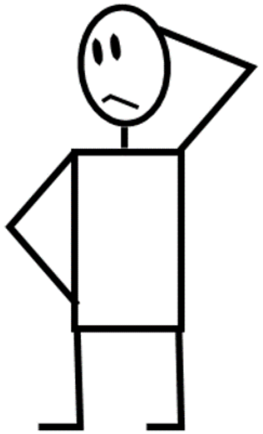
Example: An investor might seek “certainty in an uncertain environment”, taking “guarantees” at face value, rather than considering probabilities. Doomsday cults with precise dates for the end of times use this trick to attract those with the more manifest insecurities.

Consequences: Insufficient diversification –home bias: investors may feel that local stock indexes are more familiar than foreign stock indexes; Investors might go with advisers who sell “certainty” over those who present “probabilities” to gain ease of mind.

What advisers should do: Talk to clients about planning rather than assessing the future. The future might be uncertain, but if a plan is in place, that uncertainty matters less. “There’s always a probability that markets will fall 30% in a year Mr. Smith (FOI p.2), but here’s what we will do in that case. “It is my belief that X is the absolutely best course of action for you”.

“Risk is measurable uncertainty”

“Uncertainty is unmeasurable risk”



AVAILABILITY BIAS *(COGNITIVE)*

Description: A rule of thumb, or mental shortcut, that allows people to estimate the probability of an outcome based on how prevalent or familiar that outcome appears in their lives. Ideas retrieved easily also seem to be the most credible. This is how advertising (and propaganda) work.

Example: Investors focus on the latest thing they read in the papers.
An investor asked what is the "Best" mutual fund company, might automatically respond Blackrock or M&G, companies very well advertised.

Consequences: Misconception of true value, home bias. Investors tend to buy stocks in their own industry or those that fit their personalities. Investors may also chose from their own narrow life experiences.

What advisers should do: When a client calls based on "the latest thing" they read in a newspaper, it's always a good idea to point them towards our own publications and points of view, which are usually more balanced and less click-optimised content. ("Control of Information Technique") This will achieve information diversification and more reliance on our own Intellectual Capital.

SELF-ATTRIBUTION BIAS *(COGNITIVE)*

Description: The tendency of someone to disassociate themselves from a bad outcome and blame it on an external or abstract influence such as bad luck or the fault of someone else, or ascribe their successes to innate aspects such as talent.

Example: Clients (and managers for that matter) often attribute success to their own “superior” decision making process and losses to the choices of their fund managers.

Consequences: 2 primary ways can impair investors who irrationally attribute successes and failures: First, people are unable to learn from mistakes if there is no responsibility taken over them. Second, overconfidence in one’s ability can become detrimental in the context of the market.

What advisers should do: This is not a winnable argument. People need to feel self important as much as they often need a scape goat. In good times remind clients that markets have downturns and prepare them for the eventuality that their portfolio will, for a short period, underperform. Always listen to their complaints, however, but not a good idea to compromise the money managers.

ILLUSION OF CONTROL BIAS *(COGNITIVE)*

Description: The tendency of individuals to believe that they can control or influence outcomes, when they cannot.

Example: An investor who looks at their portfolio every day, fretting about returns. A person who clicks the elevator button, even though it might already be lit.

Consequences: Can lead investors to trade more than is prudent, trying to time the market.

What advisers should do: Explain to investors that market-timing techniques seldom work and focus on long term returns of assets. FOI p. 9 – Talk about diversification. Worriers seldom watch more than one assets.

CONSERVATISM BIAS *(COGNITIVE)*

Description: A mental process where people cling to their prior views at the expense of acknowledging new information. People may overreact to information that is easily processed, such as scenarios and concrete examples. Sticking to what you know rather than following the facts.

Example: *A client fixated on a particular theme or stock, or manager, ignoring other opportunities.*

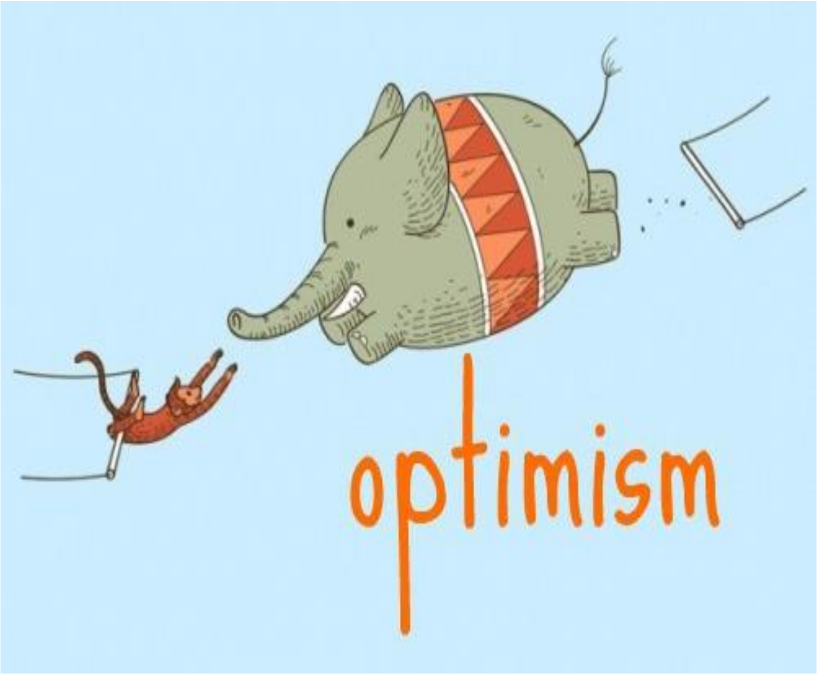
Consequences: Persistent biases. Unable to act rationally because they are "stuck" on prior beliefs.

What advisers should do: Wear out resistance by letting client say his peace uninterrupted. Temporarily change the topic of conversation. See "Dealing With Scepticism Techniques in Session 6".

OPTIMISM BIAS (COGNITIVE)

- **Description:** Investors tend to be overly optimistic about the markets and the potential for positive performance of their investments. Many overly optimistic investors believe that bad investments will not happen to them—they will only afflict "others." Linked to self-attribution bias.
- **Example:** At the end of 2000, 62 percent of Enron's 401(k) plan assets were invested in Enron common stock. Investors often don't like to think of the "bad scenarios".
- **Consequences:** Optimism bias can cause investors to think they are above average investors, simply because they are optimistic people in general. Also they might avoid advisers who may give them "bad news" and prefer advisers who confirm their beliefs.

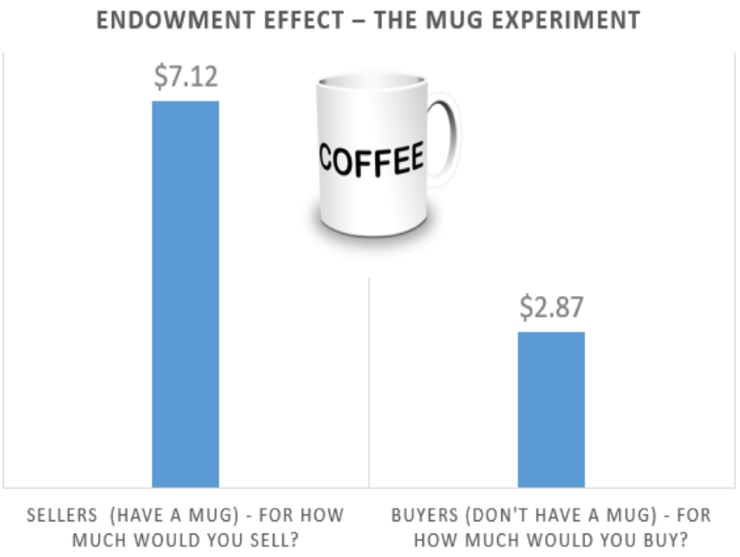
What advisers should do: Optimism is as much cognitive as it is emotional. An investor should not be discouraged but always presented with the risks and a "fair and balanced view". The goal is to temper unwarranted optimism. It is often a good practice to evoke an authority that the client might respect (Expert Altercast).



ENDOWMENT BIAS (EMOTIONAL)

- **Description:** Endowment bias is a mental process in which a differential weight is placed on the value of an object. That value depends on whether one possesses the object and is faced with its loss or whether one does not possess the object and has the potential to gain it.
- **Example:** A client who already owns a house will place more value on it rather than if he was buying it. A client who has invested for a long time in a stock might insist on holding it in the portfolio, despite dismal prospects.
- **Consequences:** It causes investors to hold securities that they have either inherited or purchased because they are familiar with the behavioural characteristics of these endowed investments.

What investors/advisors should do: The "penny wise, pound foolish" is the most salient argument that you can present to a client in this case. Introduce clients to the notion of an "opportunity cost", or what they are losing by not placing their money elsewhere (Failure to obtain benefits causes dejection)



MENTAL ACCOUNTING (EMOTIONAL)

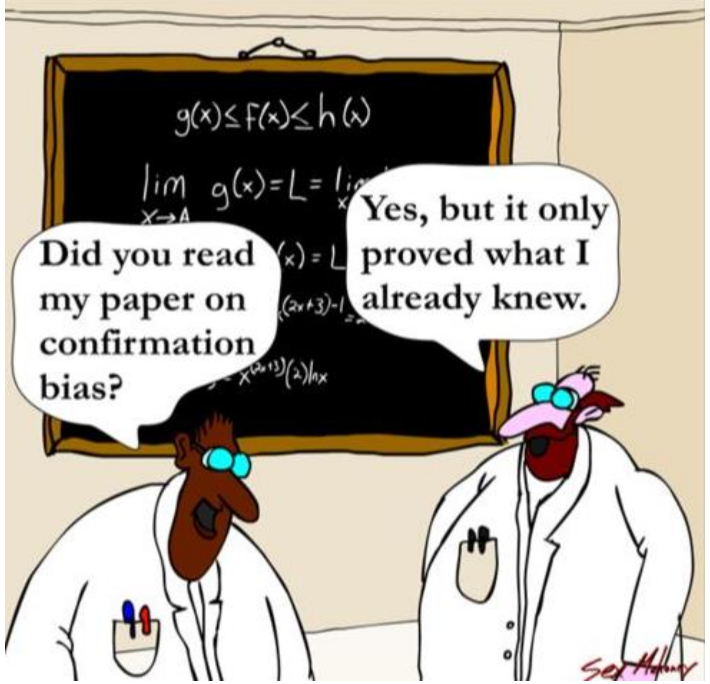
- **Description:** It is people's tendency to categorize, and evaluate economic outcomes by grouping their assets into any number of non-interchangeable mental accounts.
- **Example:** Clients often focus on one aspect of their wealth (say their portfolio with Mazars) or even a single security in their portfolio and ignore their total position and exposures.
- **Consequences:** Mental accounting bias can cause people to imagine that their investments occupy separate "buckets". Envisioning distinct accounts to correspond with financial goals can cause investors to neglect positions and lead to suboptimal portfolio performance.

What investors/advisors should do: The bread and butter of financial advisors is to investigate the total wealth and conditions of a client, and never let the discussion veer off too much into an individual holding.

CONFIRMATION (EMOTIONAL)

- **Description:** Confirmation bias refers to a type of selective perception that emphasizes ideas that confirm our beliefs, while devaluing whatever contradicts our beliefs.
- **Example:** Brexiteers believe the UK economy will do great with Brexit and only trust news confirming that. Remainers believe the opposite and dismiss data indicating economic growth.
- **Consequences:** Investors often fail to acknowledge anything different than their current point of view.

What investors/advisors should do: use the "experts" who may expose clients to a different point of view as an authority. Else, talk in probabilities: "You are probably right about A, but there's a good chance B might happen".



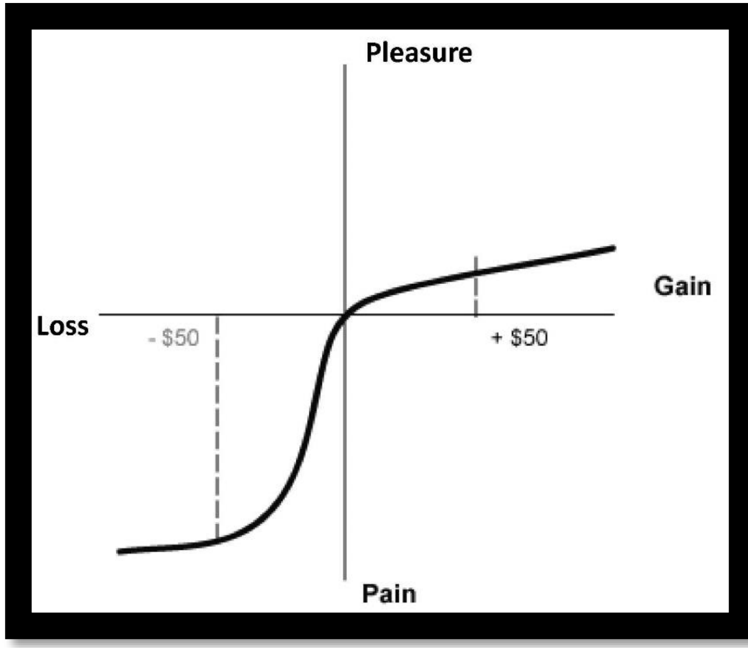
HINDSIGHT (EMOTIONAL)

- **Description:** Hindsight bias is the impulse that insists: "I knew it all along!" Once an event has elapsed, people afflicted with this bias tend to perceive that the event was predictable—even if it wasn't.
- **Example:** Following the Dot Com bubble in the late 1990s and Great Recession of 2008, many pundits and analysts tried to demonstrate how trivial events at the time were actually indicators of future financial trouble.
- **Consequences:** It gives investors a false sense of security when making investment decisions. This can manifest itself in excessive risk-taking behaviour, and place people's portfolios at risk.

What investors/advisors should do: The best thing to do with clients which tend to indulge in hindsight (usually heavily biased memory) is to keep minutes after significant meetings and relay them back to clients after the meeting. This way they avoid selective memory which is usually the culprit behind hindsight bias.

LOSS AVERSION (EMOTIONAL)

- **Description:** Psychologically, the possibility of a loss on average is twice as powerful a motivator as the possibility of making a gain of equal magnitude. This was the main finding of Kahneman's work.
- **Example:** Investors open up the monthly statements prepared by their advisors, skim columns of numbers, and usually notice both winners and losers. In classic cases of loss aversion, clients dread selling the securities that haven't performed well. The instinct is to hold onto a losing investment until, at the very least, it rebounds enough for the client to break even.
- **Consequences:** It can cause investors to sell winners too early, in the fear that their profit will evaporate unless they sell. This behaviour limits upside potential of a portfolio, and can lead to too much trading, which has been shown to lower investment returns. Also, they may keep losers until they go positive, missing opportunities



What investors/advisors should do: First, they must stop clients from overtrading. Clients with loss aversion should be convinced to invest in discretionary portfolios and then focus on the portfolio and their total wealth rather than individual securities.

REGRET AVERSION (EMOTIONAL)

- **Description:** People exhibiting regret aversion avoid taking decisive actions because they fear that, in hindsight, whatever course they select will prove less than optimal.
- **Example:** A potential client may delay signing up out of fear that markets will fall.
- **Consequences:** Regret aversion causes investors to anticipate and fear the pain of regret that comes with incurring a loss or forfeiting a profit. They also dread feeling responsible for their own misfortunes.

What investors/advisors should do: Easing a client into a decision. Clients like that had better invest small amounts in increments and accelerate when possible. The decision to "take the plunge" scares them.

RECENCY BIAS (EMOTIONAL)

- **Description:** It is a cognitive predisposition that causes people to more prominently recall and emphasize recent events and observations than those that occurred in the near or distant past.
- **Example:** Clients will often fret about the last thing they read in a newspaper (like "Brexit"), considering this their one and only risk.
- **Consequences:** Many investors implicitly presume during cyclical peaks, that the market will continue its enormous gains forever. They forget the fact that bear markets can and do occur.

What investors/advisors should do: Expose clients to a variety of risks and information. Use our publications. In the monthly, there's a prominent section with all major risks.

"Your evaluation is based on the next 30 seconds. Go!"

FRAMING (EMOTIONAL)

- **Description:** Framing bias notes the tendency of decision makers to respond to various situations differently based on the context in which a choice is presented (framed).
- **Example:** A client may have framed a question wrong and make a wrong decision. For example: “Brexit is happening, therefore I will not invest my money”, notwithstanding the fact that they can invest in other, non GBP assets.
- **Consequences:** When questions are worded in the “gain” frame, a risk-averse response is more likely. When questions are worded in the “loss” frame, risk-seeking behaviour is the likely response.

What investors/advisors should do: to properly frame an argument one must first understand the source of the mis-framing and address it. That requires very attentive listening.

STATUS QUO BIAS (EMOTIONAL)

- **Description:** It is an emotional bias that operates in people who prefer for things to stay relatively the same.
- **Example:** Take the case of a grandson who hesitates to sell the stock he’s inherited from his grandfather. Even though his portfolio is under diversified and could benefit from an adjustment, the grandson favours the status quo.
- **Consequences:** It can cause investors, by taking no action, to hold investments inappropriate to their own risk/return profiles. This can mean that investors take excessive risks or invest too conservatively.

What investors/advisors should do: Talk about tactical and strategic asset allocation, as well as the need to remain mobile. Clients who exhibit this particular bias should be in discretionary management.

MAZARS

KEY TAKEAWAYS

1. Do a financial “spring clean”
2. Stay focussed on your long term goals
3. Build a lifetime cashflow model
4. Don’t panic!

CONTACT

Jose Vilchez
Chartered Financial Planner
Jose.vilchez@mazars.co.uk
+44 (0)7881 283632

George Lagarias
Chief Economist
George.lagarias@mazars.co.uk

Mazars LLP. London. Tower Bridge House, St. Katharine's Way, London E1W 1DD

Visit us online at www.mazars.co.uk

Follow us:

Mazars Financial Planning Ltd is registered in England and Wales No 3172233 with its registered office at Tower Bridge House, St Katharine's Way, London E1W 1DD. Mazars Financial Planning Ltd is authorised and regulated by the Financial Conduct Authority. Mazars Financial Planning Ltd is a wholly owned subsidiary of Mazars LLP, the UK firm of Mazars, an integrated international advisory and accountancy organisation.

About Mazars
Mazars is an international, integrated and independent firm, specialising in audit, accountancy, advisory, tax and legal services. Operating in 89 countries and territories, as of 1 January 2019, the firm draws on the expertise of 23,000 professionals to assist major international groups, SMEs, private investors and public bodies at every stage in their development.

FT ADVISER
TOP 100 FINANCIAL ADVISERS
MEMBER 2018
Mazars Financial Planning Ltd

FINANCIAL PLANNERS CII CHARTERED

CISI CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT
ACCREDITED FINANCIAL PLANNING FIRM™

GOLD STANDARD AWARDS 2018 WINNER INDEPENDENT FINANCIAL ADVICE

thewealthnet
Top Financial Planning Companies 2018

MAZARS

M MAZARS