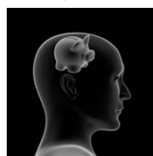


Behavioral Finance

Exchange Traded Forum 2012

Lisa Kramer, Ph.D.

Associate Professor of Finance &
Canadian Securities Institute Research Foundation Term Professor
Rotman School of Management, University of Toronto



© Lisa Kramer 2012

Key Takeaways I

- Emotions:
 - Recognize that emotions can influence financial decisions.
 - Discourage decision-making during emotional times.
 - Collect baseline information only during non-emotional times.
- Anchoring:
 - Recognize the role quantitative information (even irrelevant quantitative information!) can have in setting baseline expectations.
 - Does it make sense to start meetings by going over the portfolio's past performance?
 - Does it make sense to decide whether or not to continue holding a security in relation to its original purchase price?

© Lisa Kramer 2012

Key Takeaways II

- Choice Overload:
 - Resist the temptation to present comprehensive lists of alternatives.
 - Start with a broad set of representative categories rather than presenting all possible choices.
 - Once an initial choice has been made, it's always possible to present an array of sub-choices.
- Mental Accounting:
 - Discourage attempts to optimize within mental buckets which can lead to sub-optimal overall decisions.
 - Encourage consideration of the full portfolio.
- Biases & heuristics in general:
 - Don't assume awareness of a human tendency leads to immunity!

© Lisa Kramer 2012

Key Takeaways III

- Standard financial advice still works!
 - Diversify; develop a long-term plan and stick to it.
 - Use quantitative investment criteria when considering risks.
 - Discourage frequent glimpses of portfolio.
 - There is no shame in matching the market performance.
- ETFs are an advisor's friend.
 - Their use can help clients avoid some biases.
 - But watch out for ETFs that stray from their NAV.
- Emphasize the value-added you can provide as an advisor:
 - Can serve as a filter
 - Consideration of full portfolio (real estate, employment income, ...) & lifestyle factors (retirement, kids' education, ...)
 - Tax implications of decisions, insurance planning, ...

© Lisa Kramer 2012

Additional Resources

- Predictably Irrational, by Daniel Ariely
- Beyond Greed and Fear, by Hersh Shefrin
- Nudge, by Richard Thaler and Cass Sunstein
- How We Decide, by Jonah Lehrer
- The Art of Choosing, by Sheena Iyengar

My Twitter feed: @ProfLisaK

© Lisa Kramer 2012