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Million Dollar Baby

How Clint Eastwood can help your clients make better investment decisions.

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** DISCLOSURE: Readers should assume that all financial advice in this column is the author's. The views expressed in this article do not necessarily reflect the views of the AICPA or the Wealth Management Insider.*

I learned a great deal about investing a few years ago when I saw Clint Eastwood's award-winning movie, *Million Dollar Baby*.

Eastwood plays a cynical grizzled boxing trainer, who reluctantly takes on an aspiring female pugilist (Hillary Swank). She's positive, respectable and extremely hard-working as she climbs up the ranks. But in her biggest match, she's physically destroyed when her dirty-dealing opponent lands a sneaky "sucker" punch after the bell signaling the end of the round and the end of her fighting career. She didn't follow her trainer's mantra all the way – always protect yourself.

It occurs to me that the same thing can happen with investments. The admirable fighter inside your client tries to make their financial dreams come true. That's the inner voice that tells them to work hard and invest smart. Their opponent is the part ruled by their emotions. Those emotions look for every opportunity to land a sucker punch and bring them down.

If there was ever a time to be emotional about money, it might be right now. Think about what happened in the stock market in January alone. After reaching all-time highs last October, both the S&P 500 and the Dow Jones Industrial Average (DJIA) gave back 16 percent of their gains by late January. The NASDAQ and the small-cap Russell 200 fell 20 percent. Those are steep losses and it would be almost unimaginable for an investor to be calm during such periods.

How many frantic phone calls have you received from clients asking what they should do? Too many, I am sure.

As emotional as these times are, my experience tells me that if your clients allow their emotions to impact their decision-making processes, they might as well throw in the towel. I say this because their emotions will cost them the fight every time — in good times and bad.

Take Bill for example.

When I first met Bill he was worth $10 million, yet he was miserable. Because he'd grown up during the depression, he was convinced that he was always one step away from being broke, hungry and homeless. Keep in mind that Bill was taking only $150,000 a year from his $10 million nest egg. If you do the math, you'll see that his withdrawal rate was barely 1.5 percent. So Bill really didn't have to worry about money ... but he worried anyway, and he was ruled by his fear and greed.

Because Bill was convinced that he was going to run out of money, he continued to make high-risk investments in the hopes of having more. He often lost a great deal of money with these chancy ventures, and this behavior made his fear a self-fulfilling prophecy. As his losses grew, so did his emotional need to make up for those losses. He took ever-greater risks and continued to dig himself into a miserable hole. Throwing good money after bad is a classic emotional smack-down.

Others dance in the opposite direction. People who suffer great investment losses understandably become gun-shy. They are afraid of getting pounded again, so they swear off investing forever — and miss out on securing their financial future.

Are your clients' emotions beating up their investments? Do they take risky chances for no good reason? Or is their anxiety making them afraid to come out of the corner fighting? Let me share something with you — in the arena of investments, emotions are always in the backroom working the speed bag, just waiting for the chance to deck your clients. They need an edge if they want to stay in the ring.

Tips on Protecting Your Clients

How would you like to be the financial equivalent of Muhammad Ali as your clients' trainer? Here are a few tips that can give them that kind of an edge.

First, recognize that investors can never totally eliminate emotions from their financial decisions. They can't knock them out, but they can learn to neutralize them.

How? Remember the trainer's advice: Always protect yourself.

One way to keep your clients' guard up is to use "stop-loss" provisions on all their investments. If you're not familiar with a stop-loss, it's a simple tool you can use to reduce risk. Let's say you buy a stock at $50, and you're convinced the stock is going to climb to $80. Put a stop order of $45 on the position just in case. If the stock goes all the way, the stop doesn't come into play. But if you're wrong, and the stock hits the mat, the stop-loss triggers a sale of the stock at the $45 price point and you lose no more than five dollars per share on that investment.

What happens if the stock later renews its strength and climbs back to $80? Too bad. You sold at $45, and you no longer hold the position. This is the downside to using stop-loss orders.

What happens if the stock continues its downward spiral and falls to $15? You don't care because you sold the position at $45. Could this happen? It happens every day. Just ask people who bought tech stocks in the early part of 2000.

Your clients can effectively use stop-loss orders to limit downside risk on all their stock investments.

Another (and perhaps more important way) to protect against your emotions is to have a written investment strategy — and review it often. Before your clients invest, they must know why they are investing, the time frame over which they plan to invest and what the risks are. If they aren't comfortable with the risks, they should not get into the ring. Help your clients make sure their portfolio strategy matches up with their personality.

Your clients can use stop-loss orders and an investment strategy policy to protect themselves while investing. If they do this, they'll be able to go the 10 rounds without getting knocked silly by their emotions.

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Neal Frankle *is the author of* Why Smart People Lose a Fortune: 5 Steps to Restoring Your Wealth and Sanity. *He helps affluent clients establish and implement a safety-net strategy to protect their wealth. He also helps other professionals, such as CPAs, do the same for their clients. If you would like a free monthly e-newsletter (written especially for CPAs to use with their clients so they make better investments) please e-mail Neal.*

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