Mullooly Asset Show: Episode 51 – Risk Tolerance Questionnaires - Transcript

Tom Mullooly: I'll bet you didn't know that risk tolerance questionnaires can be really exciting. Welcome to the Mullooly Asset Show. I'm your host, Tom Mullooly, and this is Episode 51. The 51st state. Where do we get these questions from? They come from you. They come from our listeners. They come from clients. They email us, they reach out to us, and we talk about lots of interesting topics, so if you've got something that is burning a hole and you need an answer to, get in touch with us. Could wind up on a future video. Tim, what are we going to be talking about today?

Tim: I've been getting a handful of questionnaires from my advisor. What's the purpose of them?

Tom Mullooly: The purpose of them is for the advisor to know your client, and if you know someone who's a broker or an advisor in the business, just say that phrase, know your client. It's a very important phrase in our industry, know your client, so what that means is, you can't treat all your clients the same. If you have someone who's really looking for safety from their investments, they're not going to wind up with the same basket of investments as someone who wants long-term growth, so you got to know your client. You also have to know that your client's situations can change. It sounds like I'm talking to advisors and brokers. I am to a certain degree, but I'm also talking to you, the investors. Know your client is a really big deal. The regulators insist that advisors and brokers know their client, but they don't give any kind of specifics on how to do that. It's really hard to quantify something that can't be quantifiable. We can't really take your temperature on a daily basis and see how you feel about taking risk, or how you feel about not taking any risk at all.

We also know that people's attitudes about how much risk they want to take can change over time. One of the big trends in the business right now is to computerize, and to put more things into models, and you've probably read or heard the term robo advisors. I'm here to tell you that I believe human advisors may be actually a little better if they're paying attention. They may be a little better at sniffing out people's attitudes and feelings about taking risk. I don't think that filling out a form, or checking a box on a website, or going through some robo advisor process, is going to help you get a handle on how much risk you can be taking with your investments. There's another phrase that I want to introduce at this point called recency bias, and recency bias, a great way to explain recency bias is, if you look outside, it's sunny today. It maybe looks like it's going to be sunny tomorrow, right? After all, we're recording this in August, so we tend to see what's happening today is going to happen tomorrow and in the future.

Tomorrow it might not be 85 and sunny. It might be raining. We know that in a couple of weeks, it's going to start getting cooler, and in a few months from now we're actually going to have snow on the ground, so let's translate recency bias to filling out these risk tolerance questionnaires. When the market's calm, and really nothing's been happening, or the market's doing one of these slow, steady grinds uphill, it's really easy for people to fill out questionnaires and say, "I can handle losses. I can take care of that. I'm okay with losses. I'm okay with losing 10%." That's why when we send out these questionnaires to clients in the past, when we talk about a market going down 10%, we also give you a dollar figure, so we say, "Hey, if you've got a $300,000 account, and the market falls 10%, that's 30 grand. How do you feel now, seeing a $30,000 hole blown in your account statement?" A lot of people aren't too cool with that, and so we like to talk about risks not only in percentages, but in dollar terms, in real terms that everybody can understand.

Our very own Brendan Mullooly was quoted very recently in U.S. News and World Report. Tim, can we link to that in the show notes? Okay, so Brendan was quoted in U.S. News and World Report. We're very proud of him, and one of the things that he was quoted saying is that questionnaires lack context. They really can become, if they're not handled right, they can become a tool, really, for performance chasing. One of the things that we've found, and Brendan's pointed this out a lot, is that when the market's going up, all of these reports, all these questionnaires come back from clients, and they're saying, "We can take a lot more risk. We should be taking more risk than we're doing right now," because they see the market moving up. When we send these questionnaires out to clients, and the market has been down, or a lot more volatile, we start getting back responses saying, "We don't want to take more risk. We want to be more conservative," from the very same people, the very same people.

One of the things that frightens us as advisors are people who call in, and change the risk profile on a regular basis, depending on what's happening in the market. It's really hard to work with someone who changes their stripes from day to day, month to month, year to year. If they're saying, "Hey, the market's up. Let's take more risk, or the market's going down. I want to be conservative now," we'll kind of let people slide once, but that's it. We won't let them change their risk profile more than once because it just doesn't make sense. All we're doing now is performance chasing. We're going to be moving into sectors at the top. We're going to be buying high, and we're going to be selling low, and it's just a recipe for disaster. That is a great question we had about risk tolerance questionnaires. You get them because your broker, your advisor, wants to know or at least get a better handle on what investments are appropriate for you. Great question. We'll see you back here, and Episode 52. Thanks for watching.