Sarah Newcomb about personal financial decisions: people should discover their internal stories

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Het centrale thema van dit nummer is de wijze waarop mensen financiële beslissingen nemen. Zijn zij in staat dat op een rationele wijze te doen of laten zij zich beïnvloeden door (onbewuste) emoties?
Sarah Newcomb heeft een interessante en uitgesproken visie op het beslissingsproces. Zij raadt mensen aan eerst te onderzoeken wat hun persoonlijke drijfveren zijn. Als dat lukt is het mogelijke om beter overwogen beslissingen te nemen en deze ook uit te voeren. Interessant is ook haar conclusie dat het geven van veel informatie op productniveau niet veel zin heeft.

For this edition of our journal related to financial decision-making, it would be interesting to hear from you, from a more scientific point of view, about how people make their financial decisions. Perhaps you could give a short overview of your new book, 'Loaded: Money, Psychology, and How to Get Ahead without Leaving Your Values Behind', and then we can dive into how people can make better financial decisions and how governments, regulatory bodies, banks and insurance companies can help people make better decisions?

The book focuses more on day-to-day financial decisions than investment decisions, which are the decisions that ultimately determine whether people actually have money to invest. What I'm trying to do is to get to the underlying motivations of why we spend and why we save. I'm trying to help people understand that the mental environment in which they make their decisions is important. You can make the best financial product possible, but that doesn't matter if you don't manage to reach the right people at the right time.

Internal stories have a powerful impact

The most important thing to understand about the way we make financial decisions is that underneath every single financial decision that we make is a story that we are telling ourselves. Some of these stories are true, and some of them are not. We can't avoid those stories, so it's important to understand what our stories are, so we can change those stories that we think are getting in our way.

We think of our financial point of view as factual, but it's highly subjective. An example is someone who believes that money corrupts people may have a very difficult time engaging with his finances. That's a message that is very prominent outside of the financial industry, but people inside of it have generally made peace with money and don't see it as something evil. Consequently, we in this industry can be out of touch with the fact that many of the people we are trying to reach have an underlying mistrust of the financial industry in general, and even fear money itself. If you don't understand those stories, you can't reach those potential costumers. On the flip side, you have people who associate money with freedom and opportunity, and those people, while they may earn quite a bit of money, will also tend to spend quite a bit. They may not even have money left to invest or they may want to take big risks when investing. They may tell themselves a story of money buying them freedom, excitement and status, and they're using their money to feel important. Those internal stories that we're telling ourselves have a really powerful influence over how we use or misuse the money in our lives.

We often take experiences and turn them into rules of thumb

Do you think that our attitude towards money has changed over the past few years, especially when you think about the credit crisis and the housing crisis in the United States? Have the stories that people are telling themselves changed over time?

The specific stories have changed, but there are some general stories that have remained. Our core values about money are somewhat moralistic, and tend to fall into either "money is good" or "money is evil", depending on the environment you grew up in, what messages you've been exposed to and what you've seen. Those will have emotional triggers for us, either desire or fear, and we really want to be somewhere in between – closer to stability and security. That's where a healthy relationship with money is. Our specific stories, however, are based more on our own experiences and what's happening around us, and we look for patterns and shortcuts.

Behaviour economists call these heuristics; they are just simple rules of thumb. We use these because when we make decisions, we don't have the time or the mental capacity to take in all the information every single time. Before the housing crisis in the United States, I heard people say things like "Real estate prices never go down". There was this rule of thumb that people had in their minds that real estate was always a safe investment. They didn't think about what happened in Japan 20 years before, because that wasn't close to home. Once the housing crisis happened and people realised that rule wasn't always true, now the rule of thumb seems to have shifted to "Real estate is risky", which isn't necessarily the case either. But because we want to make things simple for ourselves, we often take experiences and turn them into rules of thumb. What we really need are simple, smart heuristics based on sound economic principles, not recent experiences.

Are people aware of those stories they tell themselves?

Generally I think they are not, and that's the problem. Generally we believe we are being logical by basing our decisions on past experiences. What's really happening is that we are emotionally or personally translating experiences into rules of thumb. The issue that comes up is that those rules of thumb affect the strategies that we use financially. If you believe unhealthy stories, then you are going to use unhealthy strategies. We often try to change our financial behaviour on the level of changing our strategy, and I believe that doesn't work. We find it hard to stick to strategies when we're still listening to old stories without realising it. That's why I encourage people to think deeper about what it is that they believe about money and what their rules of thumb are. It's really hard to change your strategy without changing your story. When you change your story, it's much easier.

Sarah Newcomb

Sarah Newcomb leads behavioral research for Morningstar's HelloWallet unit, where she works to integrate behavioral science into digital financial management applications. Prior to joining HelloWallet, Sarah conducted her doctoral research at the University of Maine, with an emphasis on psychological barriers to sound financial management. Sarah aims to bridge the gap between academics and the 'real world' by translating scholarly research into practical tools and messages that empower people to build better financial habits and a healthier relationship with money.

Wealthy people were actually incredibly inspiring to me in the way that they used their resources

How can you help people discover their personal financial stories?

I have some ideas and exercises laid out in the book, useful activities that people can do. There are some simple ones. For example, writing your personal financial narrative; your story with money right up and until now. If you had to imagine money as a character in your life, has it been a friend or an enemy? Starting there can get you to some interesting personal insights. Next to that, it can be useful to imagine yourself in a position of great wealth, does that create an emotion of desire or fear? Alternatively, letting yourself finish the sentence "money is…" can even be useful. Once you identify the stories that might be holding you back, there are some tools from behavioural science that can help you change them.

If I were to ask this question to my daughter she would probably talk about things that are fun, going out shopping and spending it, whereas someone who has just lost his or her job would tell you a completely different story. Three questions How can you discover that kind of story? Do you need a sort of financial therapist to help you? And do those stories change over time?

You don't need a financial therapist to help you, but it can be an adjustment to think in this way about money, so I do recommend reading books and articles on the topic. Second, our stories certainly do change. The great thing about this is that once you recognise what your stories are, you can actively change them yourself. The reason I got into this field was because after getting a degree in mathematics, I still couldn't get my finances together. I had to realise that it was not about numbers—there was something else working against me. I had to go into training in financial planning, and ended up learning about the psychology of financial planning and the concept of money messaging. I realised that the two stories I believed had merged into a single story, that helped me identify where my financial troubles were coming from. I believed that I did not deserve to have a lot of money and that money was bad. Whenever I had money that I didn't need, I felt personally guilty about it. Money to me represented barriers, greed and all the things that I saw in the world that were unfair. I was blaming money for those things, so I didn't want anything to do with it. I was afraid it was going to corrupt me. As long as that idea was in my mind, I was actually sabotaging my finances. I refused high-paying jobs and good opportunities because I was afraid of having too much money. Our relationship with money has a lot to do with how we feel about success and power. It's not just numbers to us; it's our relationship and our place in society. If we start to unpack those things, then we can start to ask ourselves if these stories are helping us make good choices or bad ones. I realised that my story was leading me to bad financial choices.

Advisors should ask clients about their personal goals and what money means to them

I had to change what I believed, so I came up with two different ways in which you can challenge your core beliefs once you figure out what they are. One of them is simply writing down your personal narrative about money, and to then think about what the "moral" of this story would be. If you do that, you can distil your entire story about your relationship with money into one core belief, which in my case was "money corrupts people". What I then did was review the story again and see if I could connect the same personal story to a different conclusion. I had to look at the story I was judging and think about a different conclusion I could draw from that story. However, what really made the difference for me is not that technique, but a second one. The second one is to find a counterexample. I come from a mathematics background, and in mathematics you can either try to prove a theorem by proving it's true in every case, or you can find one case where the theorem does not hold, and then you've disproved it. If you find just one counterexample of where your core belief about money doesn't hold up, it creates a little bit of a crack in its power over you. You'll still find that belief coming up in your mind, but you'll be able to counter it. For example, my belief that wealthy people were greedy was undermined by simply thinking of a couple of wealthy people that were actually incredibly inspiring to me in the way that they used their resources to make the world a better place, like Elon Musk and Bill Gates. When I'm faced with the idea that money corrupts people or that the wealthy are greedy, I think about those people, and I think t"No, people are who they are and money gives you the opportunity to express who you already are". That gives me the power to realise that if that is true for Elon Musk and Bill Gates, it can be true for me as well.

Given your approach, is there a way to help people find their own financial roots? Because I hear you saying that it doesn't make sense to give financial advice to people, as long as they don't understand their own approach to money.

I think what financial and investment advisors can really benefit from is bringing psychology into the financial advising world. There is some progress in this area; some firms, like my own firm, Morningstar, are starting to integrate this. There is also a small movement of financial therapists, there's now also a *Journal of Financial Therapy*. These people tend to be clinical psychologists but also have financial expertise, or are Certified Financial Planners. They are people who have expertise in both fields and are doing research in this area. We need to blend financial decision-making and psychology more because we understand that financial decisions are not made outside of the rest of our personal lives. Every decision is taken in the context of our relationships, our goals and our dreams. We can look at the numbers and be motivated by them, but when we leave our planner's office we are motivated by all these other things. What advisors need to do is review the literature in financial therapy and start to look for the underlying stories when they listen to their clients talk. If you can understand what it is that motivates your clients, you can help these people better understand their own thought process and better tailor the advice you give them. If people are motivated by fear, they are probably going to be saying "what if" a lot. It's also not too hard to notice if people are motivated by status, excitement or freedom, or by the rush of taking risk. Advisors should ask clients about their personal goals and what money means to them, rather than for a list of facts. We are not used to talking about money in that way, but we need to. If financial advisors could offer that safe place for people to really talk about how they feel about money, they could differentiate themselves from the robo-advisors and the other options out there.

What you're telling me is that people need to become aware of how they make financial decisions and that financial advisors should help them to discover their own profiles. Do you think that giving people detailed information about the financial products they are buying will be useful? Are people able to manage their own financial futures and, more specifically, their pensions and mortgages? In the Netherlands, there is a big debate about whether we should take a collective or an individual approach to this issue.

Obviously this question will have different answers for different people. In general, if we look at the global numbers in financial literacy, most people are very financially illiterate. We need to recognise that giving people a lot of information about financial products is often overwhelming. Research about choice theory shows that too much information and too many choices is actually one of the biggest contributors to choice paralysis. When people are afraid of making the wrong decision, they just shut their eyes and don't make any decision. A financial advisor may be trying to be transparent and trying to offer them all the information they need to make the best decision, but what a financial advisor should actually be able to do is take that information and digest it for his clients into very simple terms. There is a clear role for financial advisors to help make things simple for people without talking down to them. It's hard to say whether people are actually able to manage their own financial futures. In Britain, you originally had to take an annuity for your pension, you couldn't just take it out as a lump sum of cash, but recently that's changed. Now they're finding that people are taking their money out as a lump sum, and that's a recipe for disaster. Helping people understand the difference between the asset that is producing the income stream and the income stream itself is already very tricky. It's great that in some countries you have a guaranteed income when you retire, but if we haven't also taught them some very basic rules of thumb, then they're not going to be able to manage their cash well. We need to give people information but in the form of very simple rules of thumb that people can apply to various situations.

People are taking their money out as a lump sum, and that's a recipe for disaster

Would you say that it's a good idea to have a mandatory system for people to build up their own pensions?

This gets to two different theories of behaviour science. First, there's Nudge theory—for example, helping people make the right choice by auto-enrolling them into the retirement system. But there is the argument that by doing this we are not helping ourselves become better decision-makers but compensating for the fact that we are bad decision-makers. I think we need to combine nudges with simple financial education. When we approach financial education we tend to do it as too much of a math class, with too much information and too much complication. When we educate I think we need to use smart, simple rules of thumb that are easy to remember and easily adaptable to many financial situations.

Are you also saying that the financial industry should stop making more and more complex products?

I'm not taking a stand on policy, but I think that the financial industry is not serving people well when we are consistently generating more and more complex financial products. When you look at the state of financial literacy, most people don't understand how to think about interest, or the concept of diversification, or that there is an inverse relation between the interest rate and the price of bonds. When you're handing these people a financial product that has pages of information that they couldn't possibly understand because not even financial professionals can understand them easily, you're not serving people well.

How is Morningstar contributing to this goal of more guidance rather than just more information?

We are creating content for advisors to educate investors about financial psychology. My book is one example of that, and in May we're coming out with an advisor toolkit that just contains some simple things about how advisors can talk to their clients. Like a simple questionnaire that helps advisors understand different financial personality types. Based on that type, they can speak to their clients differently. This is targeted advice that is not just based on demographic information like income, age and gender, but on the way that they think about time and the emotional relationship they have with money. We're coming up with tangible tools for advisors so they have the tools to get to know their clients in a much more holistic way.

Is there anything else that you would like to share?

When I think about the fundamentals of a healthy relationship with money, I think there are three really important things: the stories that we tell ourselves, the strategies that these stories translate into, and we often forget that our most valuable asset is ourselves. Understanding how we can make the most out of our personal resources to increase our income and create value is something we often miss.

Noot

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