

**Vanguard**<sup>®</sup>

Investment Advisory  
Research Center

# Behavioral coaching when your clients need it most

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# Agenda

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Principles of  
behavioral  
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behavioral  
coaching

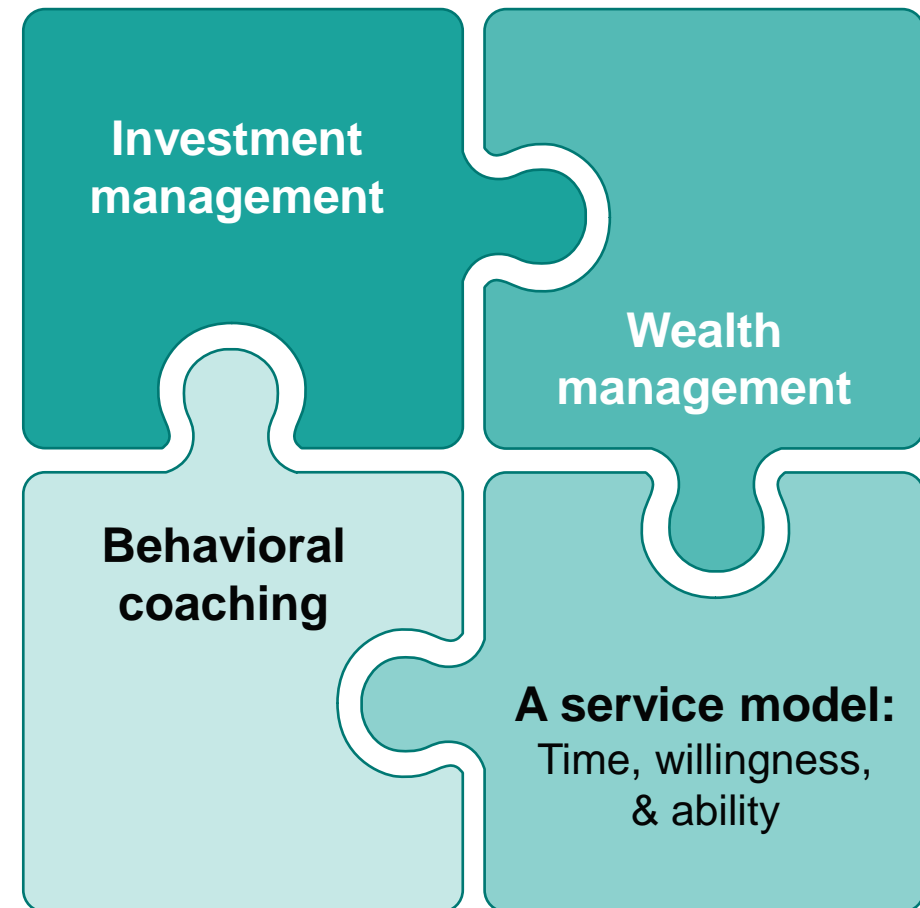
**5**

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Good for your  
clients, good  
for your practice

# The Advisor's Alpha concept

Advisor's Alpha outlines how advisors can reframe their value proposition by *prioritizing client-centric, relationship-oriented services*, such as financial planning and behavioral coaching, rather than solely portfolio management.



# 20+ years of partnership




## Vanguard Advisor's Alpha®

Vanguard Research July 2018

Donald G. Bennyhoff, CFA; Francis M. Kiniry Jr., CFA

- Since the creation of the Vanguard Advisor's Alpha concept in 2001, the value proposition of advice has continued to rapidly change—we believe for the better. And our work in support of the idea has continued.
- The Vanguard Advisor's Alpha concept outlines how advisors can add value, or alpha, by providing relationship-oriented services—such as cogent wealth management via financial planning, behavioral coaching, and guidance—as a primary objective of the value proposition.
- Paying a fee for advice and guidance to a professional who uses the framework described here can add meaningful value compared to the average investor experience, currently advised or not.
- We believe implementing the Vanguard Advisor's Alpha framework offers the opportunity to add net returns in excess of the standard fees charged for advisory services.

Acknowledgments: This paper is the most recent update of Vanguard research first published in 2010 under the same title. For additional information on the Vanguard Advisor's Alpha framework, see *Putting a value on your value: Quantifying Vanguard Advisor's Alpha®* (2018) by Francis M. Kiniry Jr., Colleen M. Jaconetti, Michael A. DiJoseph, Yan Zilbering, and Donald G. Bennyhoff and *The Evolution of Vanguard Advisor's Alpha®: From Portfolios to People* (2018) by Donald G. Bennyhoff, Francis M. Kiniry Jr., and Michael A. DiJoseph.



## The Vanguard Advisor's Alpha® guide to proactive behavioral coaching

Vanguard Research November 2018

Donald G. Bennyhoff, CFA

- Investing is an emotionally charged effort that challenges people to contend with uncertainty and doubt.
- With behavioral coaching, and by keeping the focus on the "3 Ps" discussed herein—planning, proactivity, and positivity—advisors can add considerable value to their client relationships.
- The future is uncertain for everyone. Often, it's how people—both clients and advisors—deal with this uncertainty that leads to better, mutually beneficial outcomes.

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## Putting a value on your value: Quantifying Vanguard Advisor's Alpha®


ADVISOR'S ALPHA® PERSPECTIVES | JULY 2022

### Summary

- The advice industry has changed tremendously over the last 15 years. As a result, investors are in a better position to reach their desired outcomes and the advisor's value proposition has never been stronger.
- In 2001, we outlined how advisors could add value, or alpha, through relationship-oriented services, rather than by trying to outperform the market. We have since expanded the Vanguard Advisor's Alpha concept to quantify the benefits that advisors can add by following wealth management best practices.
- We believe implementing the Vanguard Advisor's Alpha framework can add up to, or even exceed, 3% in net returns for your clients and help you differentiate your skills and practice. Like any approximation, the actual amount of value added may vary significantly, depending on clients' circumstances.
- While the data in this paper is directed toward U.S. advisors, we have estimated the benefits of implementing the framework for non-U.S. investors over multiple time periods with similar results. Additionally, the global advice markets have converged and the potential value-add of up to, or even beyond, 3% remains whether using U.S. or non-U.S. data. The specific value added by each individual best practice will vary by local tax laws, regulations, and the average advised experience in each market.

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Marie C. Quinn

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## The evolution of Advisor's Alpha®: People with portfolios

ADVISOR'S ALPHA® PERSPECTIVES | SEPTEMBER 2022

### Summary

- Current trends in investment advice—including regulation, fees, and technology-enabled competition—likely will continue to shape the contours of the industry and mold client satisfaction.
- As Vanguard's Advisor's Alpha research has suggested, for the typical advisor, the path to greater client satisfaction and asset growth should lead to an underappreciated destination—relationship management.
- A focus on relationship management takes time and commitment and requires advisors to streamline some aspects of financial planning or wealth management and reallocate the time saved to the clients who increasingly demand and value it.
- Ultimately, clients determine the value of advice, and, as our Advised Investor Insights™ research reveals, they clearly value and reward an advisor they highly trust with referrals and loyalty.
- To differentiate themselves from their competitors—both robo and human—advisors should embrace the fact that relationship management is not "customer service" but, rather, the crucial element of peerless financial advice.

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# Commoditization of advisors' traditional value proposition

As advice technology has proliferated, behavioral coaching has become more important than ever to your clients and your business.

## Benefit of moving from solely portfolio management to Vanguard Advisor's Alpha methodology

Vanguard Advisor's Alpha strategy	Module	Typical value added for client (basis points)
Suitable asset allocation using broadly diversified funds/ETFs	1	> 0*
Cost-effective implementation (expense ratios)	2	30
Rebalancing	3	14
Behavioral coaching	4	0 to > 200
Asset location	5	0 to 60
Spending strategy (withdrawal order)	6	0 to 120
Total return versus income investing	7	> 0*

**Range of potential value added (basis points)**

**Up to 3% in net returns**

\* Value is deemed significant but too unique to each investor to quantify.

Source: Francis M. Kinniry Jr., Colleen M. Jaconetti, Michael A. DiJoseph, David J. Walker, and Maria C. Quinn. 2022. *Putting a value on your value: Quantifying Vanguard Advisor's Alpha*. Valley Forge, Pa.: The Vanguard Group.

Note: We believe implementing the Vanguard Advisor's Alpha framework can add up to 3% in net returns for your clients and also allow you to differentiate your skills and practice. The actual amount of value added may vary significantly depending on client circumstances and time horizon.

# The “root cause”

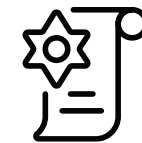
For many of life’s most important decisions, past performance, relative rankings, and rating systems work well. This isn’t always the case with investing.



**Word of mouth**



**Favorite things**



**Warranties**



**Star ratings**

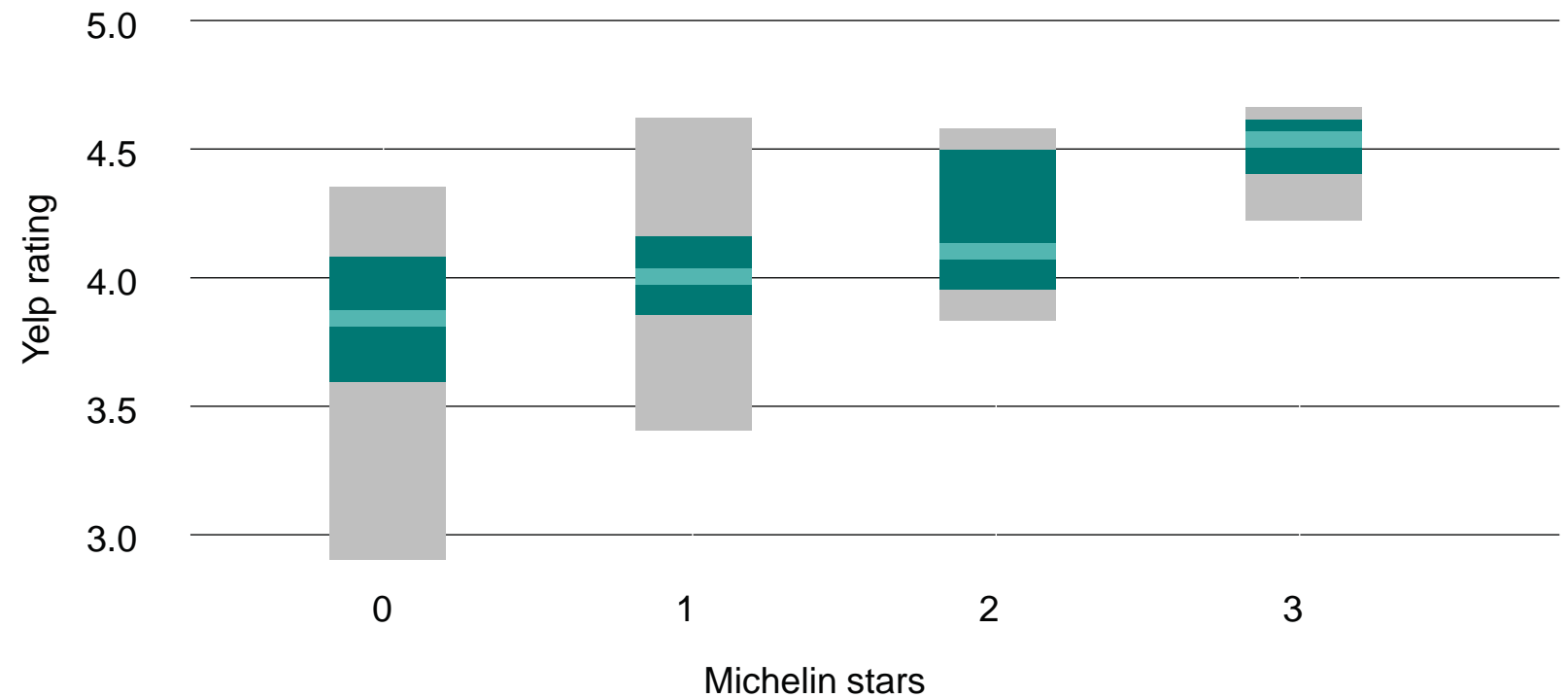


**Buyer’s guide**

# From the inconsequential ...

## Michelin stars match Yelp stars

Average Yelp review and 2015 Michelin guide rating, New York City

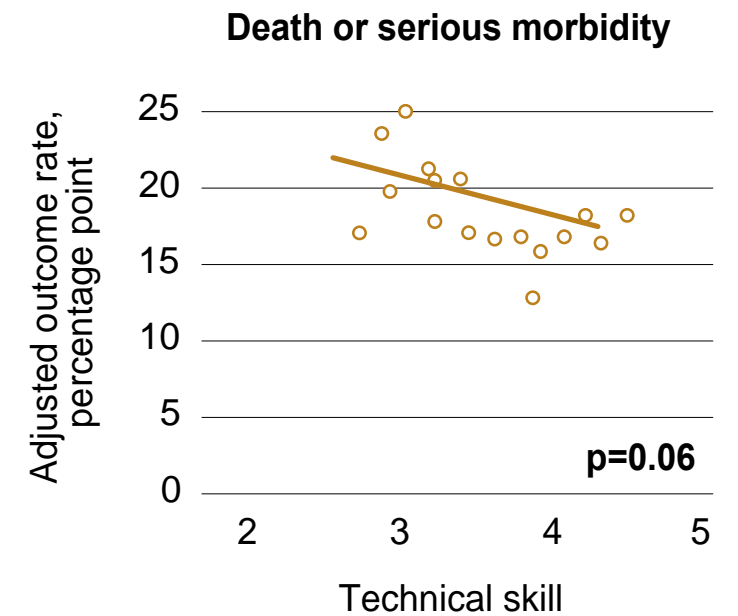
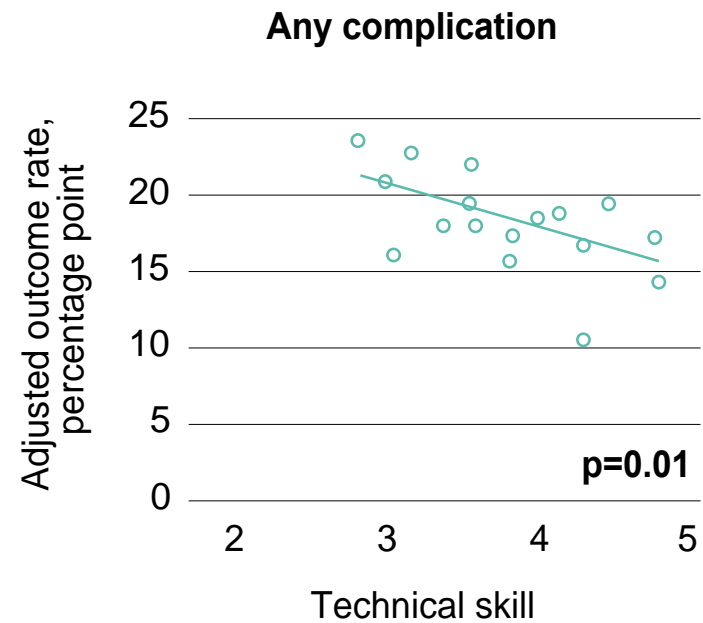


**Source:** Nate Silver, 2014. Yelp And Michelin Have The Same Taste In New York Restaurants. Fivethirtyeight.com. Available at <https://fivethirtyeight.com/features/yelp-and-michelin-have-the-same-taste-in-new-york-restaurants/>

To the extremely consequential ...

It's the right mindset

## Surgical skill

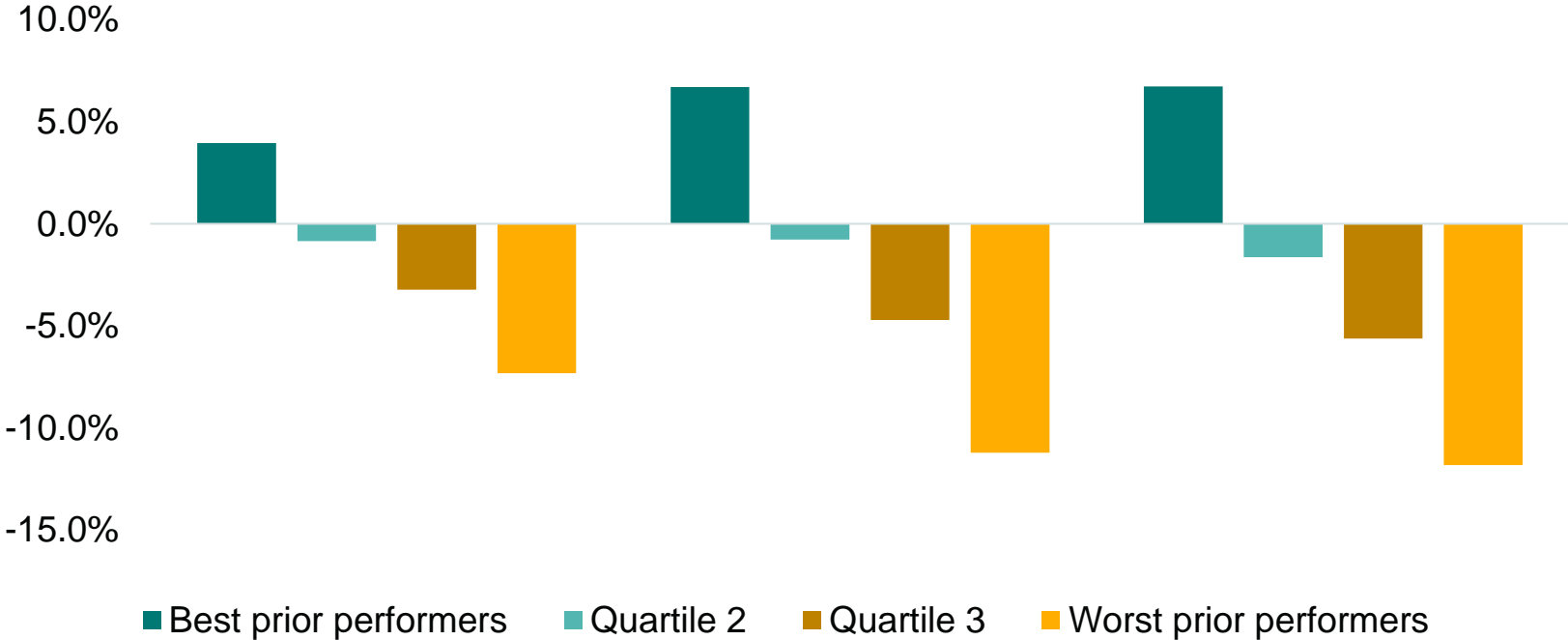


**Source:** Jonah J. Stulberg, M.D., Ph.D., M.P.H., Reiping Huang, Ph.D.; and Lindsey Kreutzer, M.P.H., August 19, 2020. Association between surgeon technical skills and patient outcomes. *JAMA Surgery* 2020; 155(10):960–968.



# Right mindset?

## Cash flows closely follow relative performance



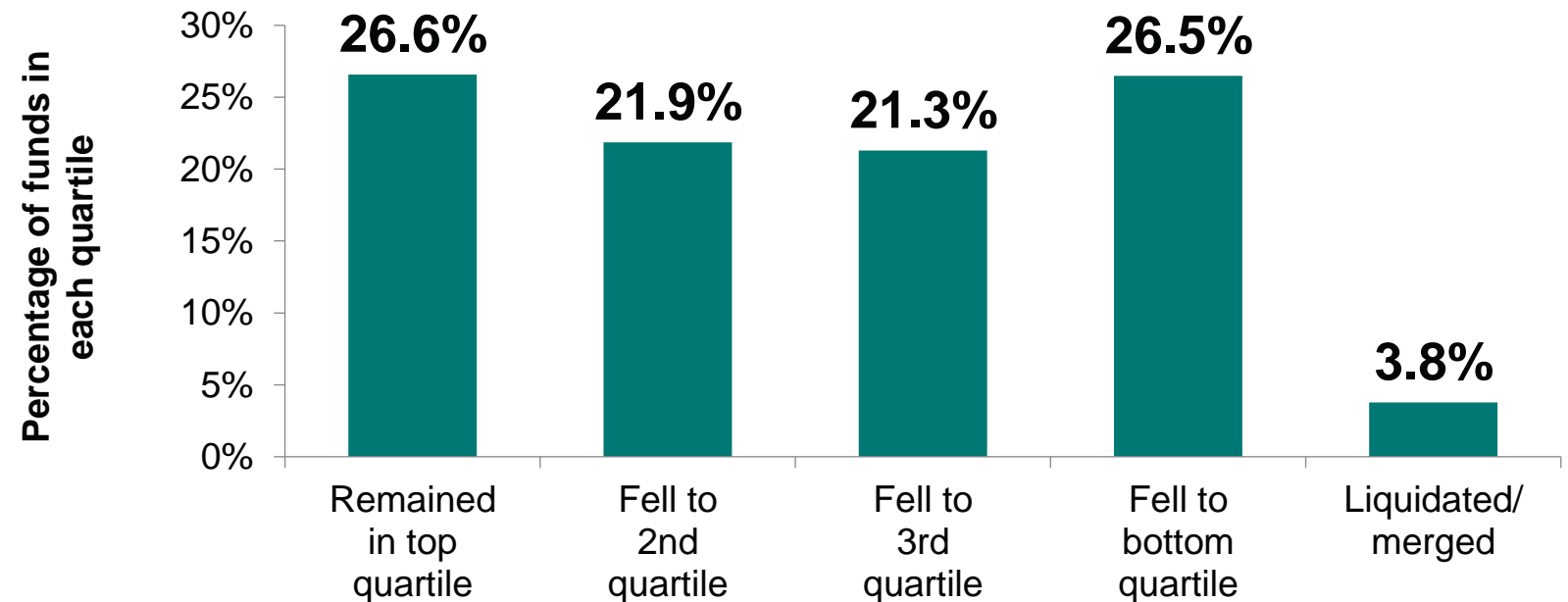
**Past performance is no guarantee of future returns.**

**Source:** Vanguard Investment Advisory Research Center, based on data from Morningstar.

**Notes:** Flows are for all U.S.-domiciled active equity mutual funds and cash flow is a percentage of the beginning-of-period base assets. The evaluation period ran from January 2017 through December 2019, with depicted chart analysis from January 2020 through December 2022.

# Wrong market!

## Subsequent three-year performance (through 2022) of funds originally ranked in top quartile for three years ended 2019



**Past performance is no guarantee of future returns.**

**Source:** Vanguard Investment Advisory Research Center, based on data from Morningstar.

**Notes:** The evaluation period of U.S.-domiciled active equity mutual funds ran from January 2017 through December 2019, with depicted chart analysis from January, 2020 through December 2022. Figures may not total 100% because of rounding.

# This process has NOT worked in capital markets

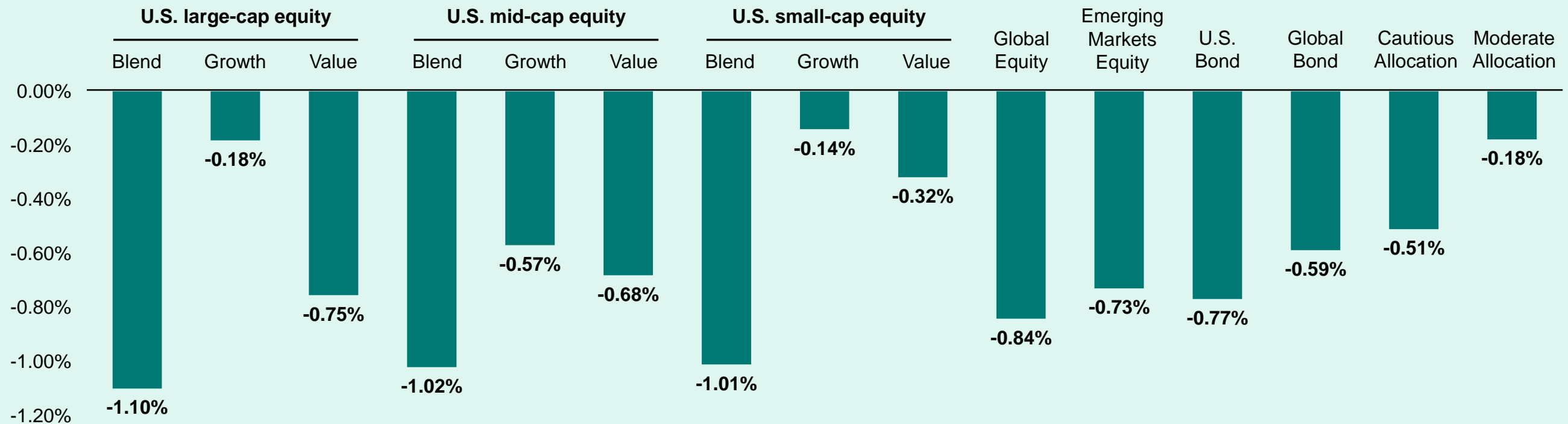
## Investment outcomes subject to:

- Randomness and cyclicalities
  - Influence and time-period dependency of initial conditions
  - Difficulty differentiating luck from skill
  - Impact of many more independent variables
  - Past leading to changes in valuations
- Therefore, insights gained by investment analysis and evaluation aren't as durable as in other life endeavors
  - Consequently, relative rating services or evaluations based on past performance break down

Francis M. Kinniry Jr., Colleen M. Jaconetti, Michael A. DiJoseph, David J. Walker, and Maria Quinn, 2022.  
*Putting a value on your value: Quantifying Vanguard Advisor's Alpha*. Valley Forge, Pa.: The Vanguard Group.

# The results

Investors, in aggregate, tend to trail the funds in which they invest, and the behavior gap tends to be larger in more narrow segments of the market and during periods of market volatility.



Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

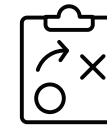
Source: Vanguard Investment Advisory Research Center, based on data from Morningstar.

Notes: All sub-asset classes (including Cautious Allocation and Moderate Allocation) are Morningstar Category classifications, as defined by Morningstar. Analysis covers the 10-year period from 2013 through 2022.

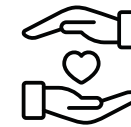
# Principles of behavioral coaching



**Planning**



**Proactivity**



**Positivity**



# Planning

- Focus on the percentages clients care about
- Put it in writing
- Start with values
- Then goals

Source: Vanguard Center for Analytics and Insights, 2019.

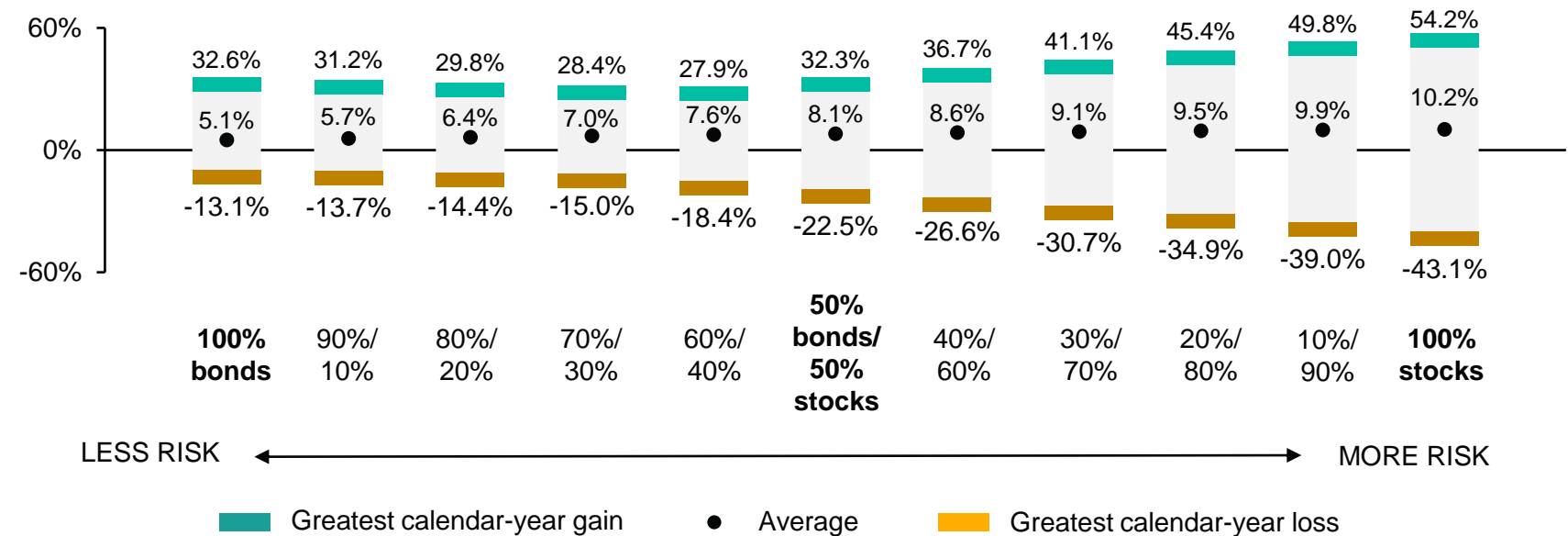


# Proactivity

- Set reasonable expectations
- Coach for tomorrow, today!

## Expected long-term returns increase with higher equity allocation, but investors bear greater risk

Range of calendar-year returns (1926 through 2022)



**Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.**

**Source:** Vanguard Investment Advisory Research Center calculations through December 31, 2022, using data from FactSet.

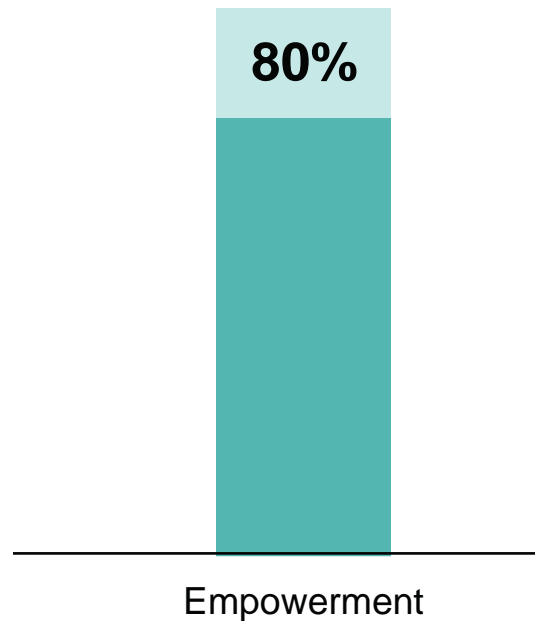
Stocks are represented by the Standard & Poor's 90 Index from 1926 through March 3, 1957; the S&P 500 Index from March 4, 1957, through 1974; the Wilshire 5000 Index from 1975 through April 22, 2005; the MSCI US Broad Market Index from April 23, 2005, through June 2, 2013; and the CRSP US Total Market Index thereafter. Bonds are represented by the S&P High Grade Corporate Index from 1926 through 1968, the Citigroup High Grade Index from 1969 through 1972, the Lehman Brothers U.S. Long Credit AA Index from 1973 through 1975, the Bloomberg U.S. Aggregate Bond Index from 1976 through 2009, and the Bloomberg U.S. Aggregate Float Adjusted Index thereafter.



## Positivity

- Positivity doesn't mean everything is fine; it means your clients are prepared for when things aren't
- Focus on empathy and understanding
- Avoid negative wording and framing

## Underlying needs



- I need to feel that I have taken charge of my financial future
- I need to feel that I have complete control over my financial decisions
- I need to feel that I am on track to meet my financial goals
- I need a financial plan that offers me financial freedom

Source: Vanguard.



# Process of behavioral coaching



**Assess**



**Address**



**Audit**



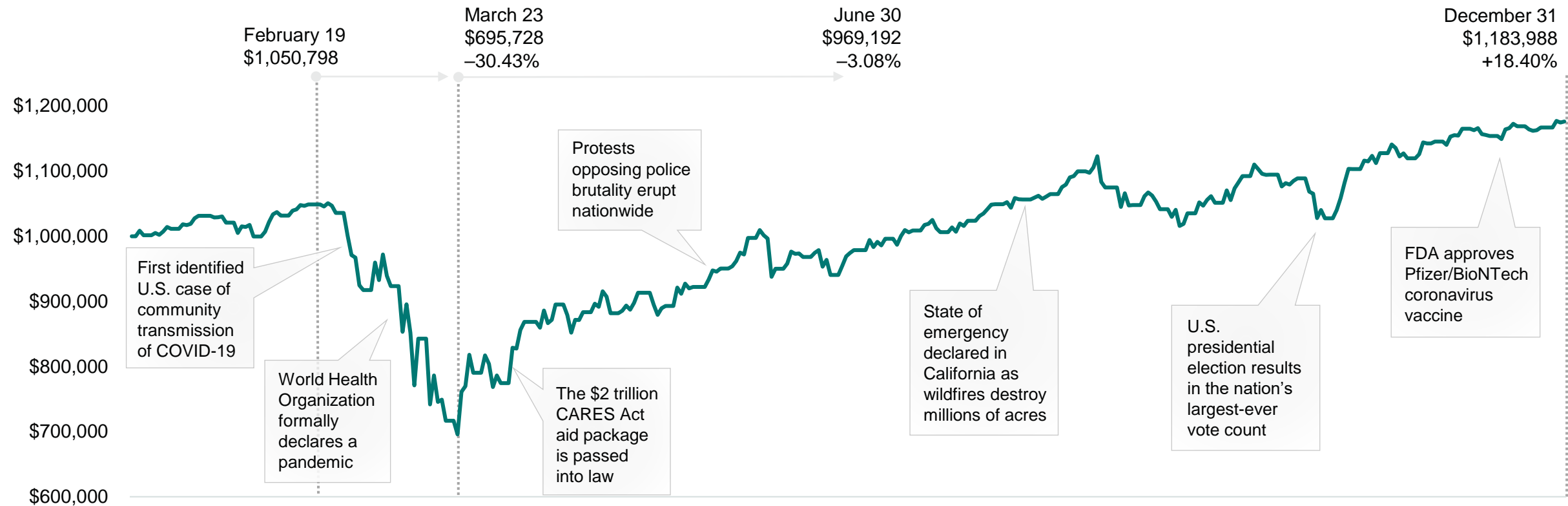
## **Assess**

- Seek historical perspective
- Determine how your clients are affected
- Develop an action plan that is proactive and reactive

# Historically, in difficult times, markets have proved resilient

Even amid the COVID-19 pandemic and widespread social unrest in the United States, the performance of the Standard & Poor's 500 Index in the first half of 2020 demonstrated the importance of staying invested

Value of a \$1 million initial investment in the S&P 500 Index, December 31, 2019, to December 31, 2020



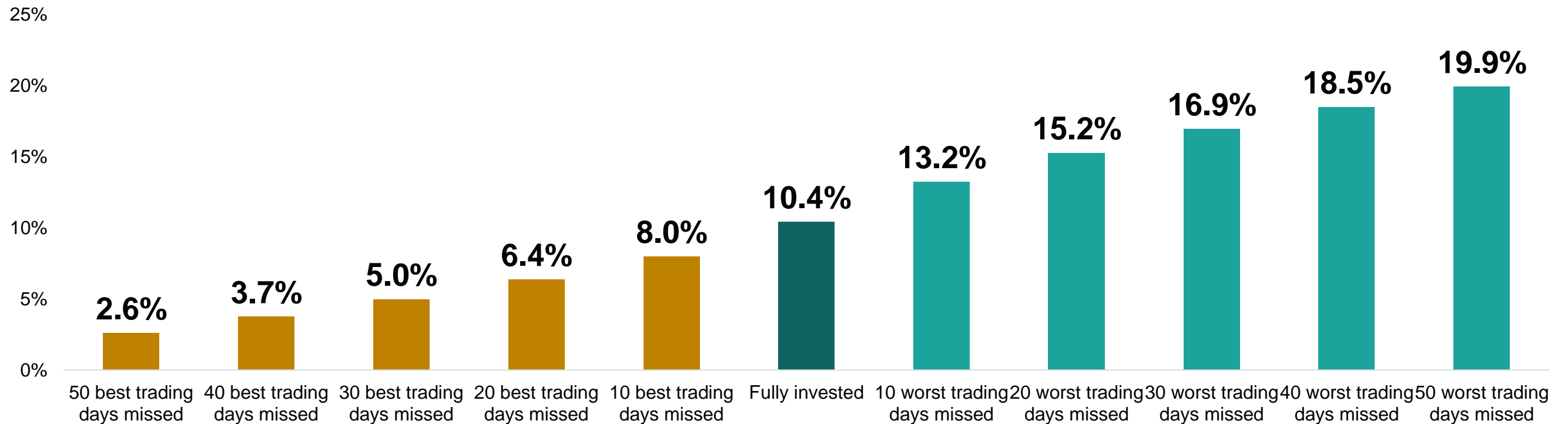
Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

Source: Vanguard, using data from Morningstar, Inc.

# Assess

## Time in the market, not timing the market!

S&P 500 Index total returns, 1988–2022 missing the best and worst days

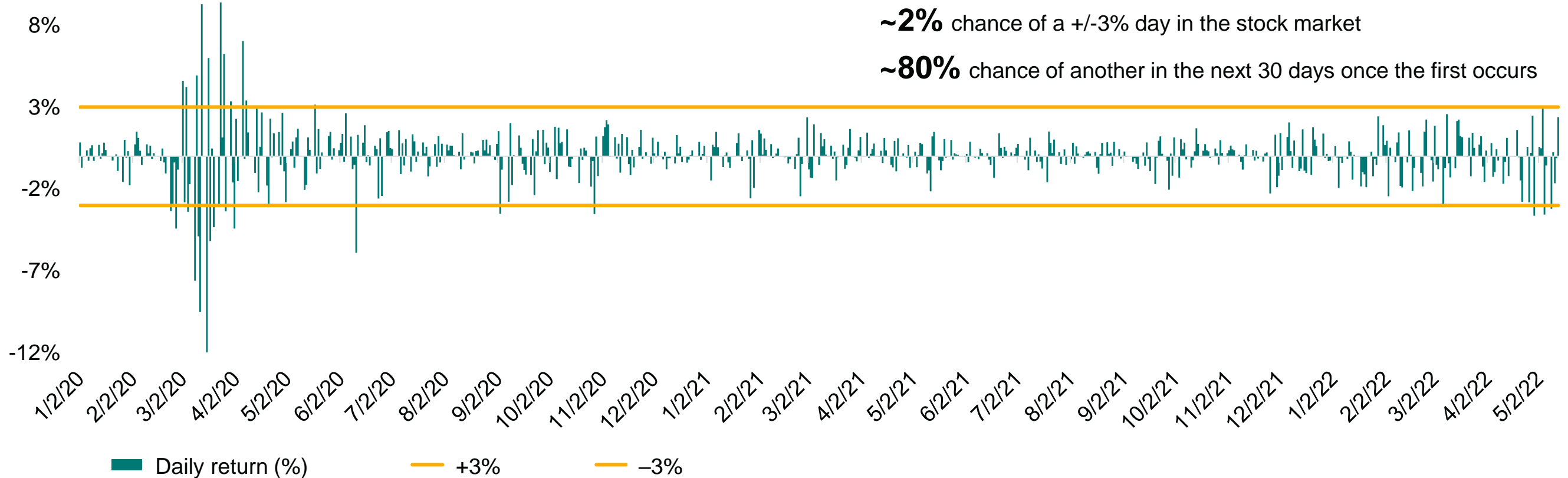


Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

Source: Vanguard Investment Strategy Group.

## The best and worst trading days tend to happen together

S&P 500 Index daily price returns January 1, 2020, through May 13, 2022



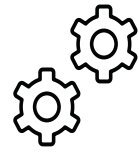
Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

Source: Vanguard calculations using FactSet data. Data through May 13, 2022. Data series for ~2% and ~80% statistics covers January 1, 1980, through May 13, 2022.



# Address

- Leverage earned trust
- Meet emotion with emotion. Back it up with informed perspective (EQ+IQ)
- Staying the course does NOT mean standing still



## Functional

Does what advisor says he/she will do

17%



## Emotional

Allows me to sleep better at night

53%



## Ethical

Will act in my best interest at all times

30%

Sources: Vanguard and Chadwick Martin Bailey, 2017.



## Address

Staying the course does NOT mean standing still.

- Rebalancing
- Tax-loss harvesting
- Portfolio cleanup
- Roth conversions
- Dynamic spending

**Sources:** Vanguard and Chadwick Martin Bailey, 2017.

# Smoothing out the ride

## No discernible pattern in the annual returns for selected market indexes: 2012–2022

2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	
18.22%	33.64%	30.38%	2.52%	12.68%	31.06%	3.16%	30.84%	20.99%	43.06%	13.75%	Emerging Markets Index
17.77%	15.59%	12.58%	1.34%	11.77%	27.41%	1.86%	25.84%	15.51%	27.05%	1.50%	CRSP US Total Market Index
17.60%	15.44%	9.14%	0.44%	11.40%	21.19%	-0.08%	21.80%	12.99%	25.72%	-12.72%	MSCI US REIT Index
16.22%	2.47%	6.45%	0.40%	8.60%	15.53%	-4.57%	20.40%	11.24%	10.69%	-13.07%	Bloomberg Commodity Index
12.05%	1.18%	5.85%	0.03%	7.05%	5.07%	-5.01%	19.79%	7.75%	8.84%	-16.07%	Spliced Bloomberg USAgg Flt Adj
6.46%	0.05%	1.24%	-0.60%	4.90%	3.63%	-5.17%	8.87%	4.75%	1.47%	-16.10%	Bloomberg Global Agg ex-USD Flt Adj Hdg
4.32%	-1.97%	0.03%	-4.29%	4.72%	2.57%	-12.99%	8.06%	0.58%	0.05%	-17.58%	FTSE Global All Cap ex US Index
0.07%	-4.28%	-3.39%	-15.40%	2.75%	0.84%	-14.61%	5.44%	-3.50%	-1.58%	-19.49%	VGI 60/40 stock/bond
-1.14%	-9.58%	-17.04%	-24.70%	0.27%	0.75%	-14.76%	2.25%	-7.57%	-2.10%	-24.51%	FTSE 3-Month US T-Bill Index

Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

Source: Vanguard Investment Advisory Research Center using data from CRSP, MSCI, FTSE, and Bloomberg.

Notes: Emerging Markets index is a spliced index consisting of MSCI Emerging Markets Index Net USD through January 9, 2013; FTSE Emerging Transition Index through June 27, 2013; FTSE Emerging Index through November 1, 2015; FTSE EM All Cap China A Trans Idx through September 18, 2016; and FTSE EM All Cap China A Incls Idx thereafter. The VGI 60/40 stock/bond portfolio is 60% CRSP US Total Market Index/40% FTSE Global All Cap ex US Index for the equity portion of the portfolio and 70% Bloomberg US Aggregate Float Adjusted Bond Index and 30% Bloomberg Global Aggregate ex-USD Float Adjusted RIC Capped Hedged Index for the bond portion.

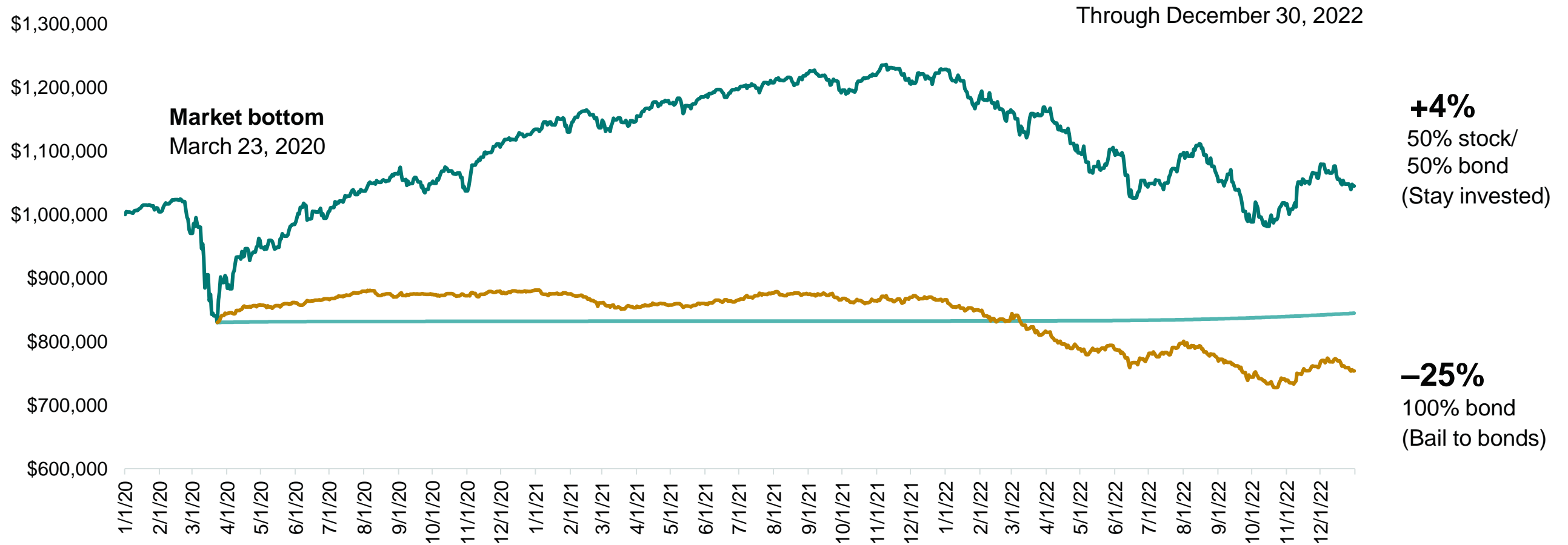




## Audit

- Keep track of decisions made (and not made)
- When the dust settles, look back at what occurred and educate your clients on your value
- Consider what could work even better next time

# The COVID-19 crisis tells the stay-the-course tale

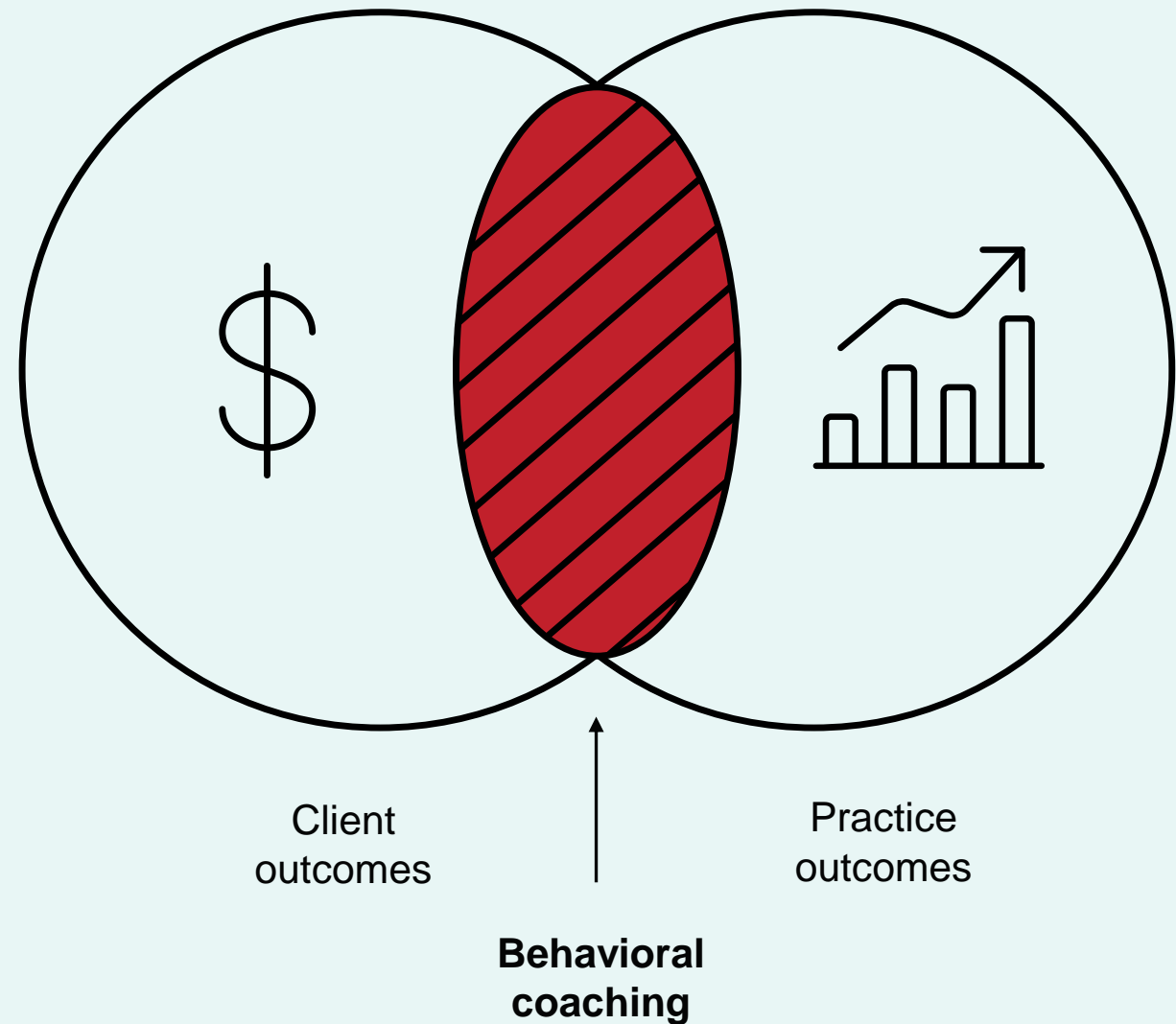


**Hypothetical example. Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.**

**Source:** Vanguard Investment Advisory Research Center calculations through December 31, 2022, using data from FactSet.

The equity portion of the 50% stock, 50% bond portfolio consists of 60% CRSP US Total Market Index and 40% FTSE Global All Cap ex US Index. The bond portion consists of 70% Bloomberg U.S. Aggregate Float Adjusted Index and 30% Bloomberg Global Aggregate ex-USD Float Adjusted RIC Capped Hedged Index. Cash represented by the FTSE 3 Month US Treasury Bill Index. The 100% bonds portfolio consists of 70% Bloomberg U.S. Aggregate Float Adjusted Index and 30% Bloomberg Global Aggregate ex-USD Float Adjusted RIC Capped Hedged Index. "Stay invested" refers to keeping all assets in the 50/50 stock/bond portfolio and rebalancing monthly.

# Good for your clients, good for your practice



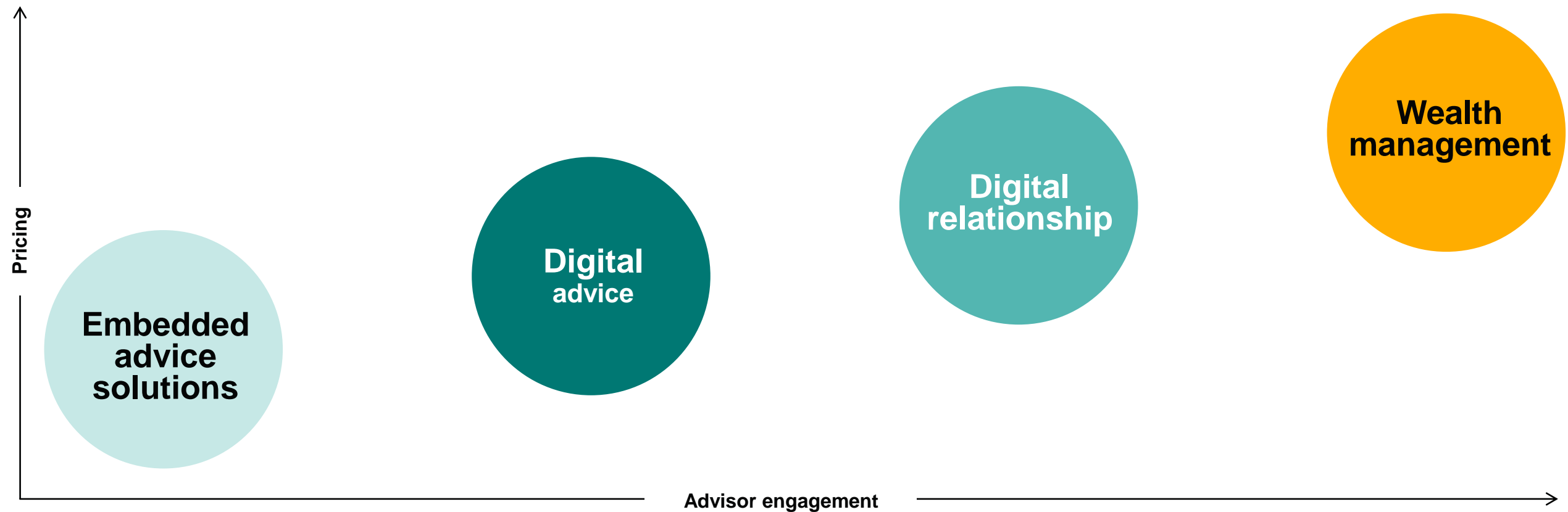
Source: Vanguard.

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# More consumer choice, more competitive industry

- There is room for many types of advice
- How do you differentiate?

## The efficient frontier for advice services



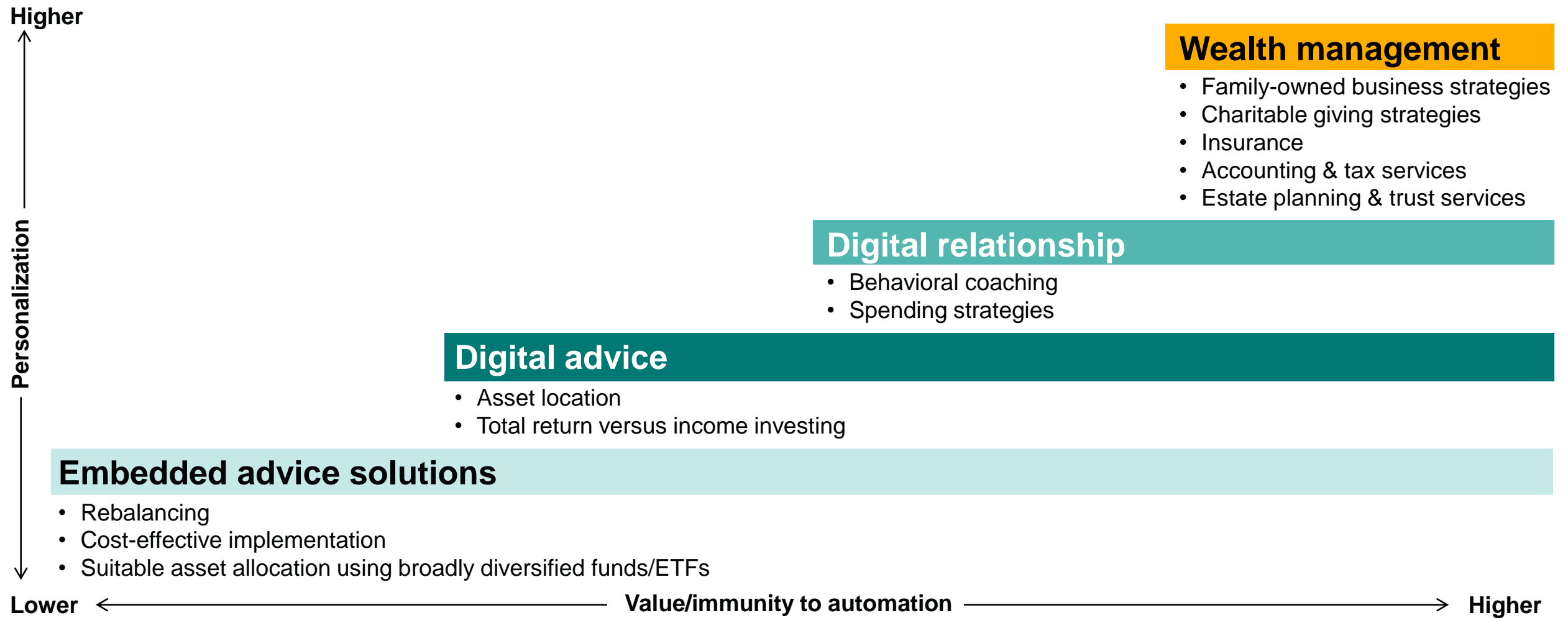
Source: Vanguard.

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# Move up the value stack of advice!

## Value stack of advice

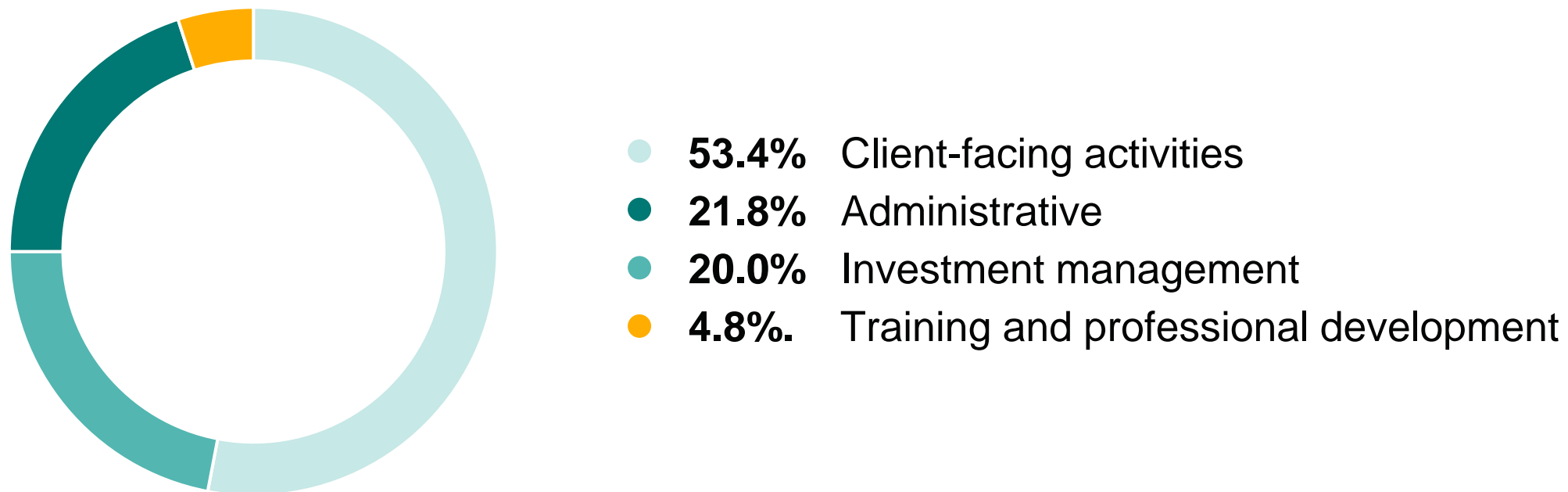


Source: Vanguard.

# Your time is an asset to be invested

- Time is also your most scarce resource
- Where is the return on time the highest?

## Advisor time allocation by activity



Source: Cerulli Associates, U.S. Advisor Metrics, 2021.

# Focus on the uniquely human

- Automate low value-add tasks
- Invest time in advanced tasks to differentiate your service offer

## Advanced skills remain uniquely human



### Basic

- Growing
- Harvesting
- Digging
- Moving objects
- Recording information



### Repetitive

- Inspecting
- Monitoring
- Assembling
- Getting information
- Processing information
- Scheduling



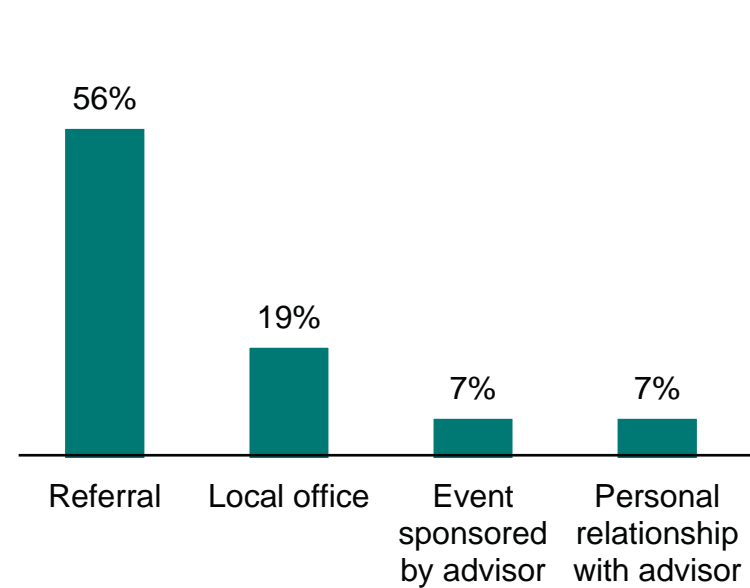
### Advanced

- Maintaining relationships
- Interacting with the public
- Persuading outcomes
- Training
- Developing teams
- Applying knowledge
- Strategizing
- Thinking creatively
- Solving problems
- Assisting/caring for others
- Judging quality
- Conducting complex physical movements

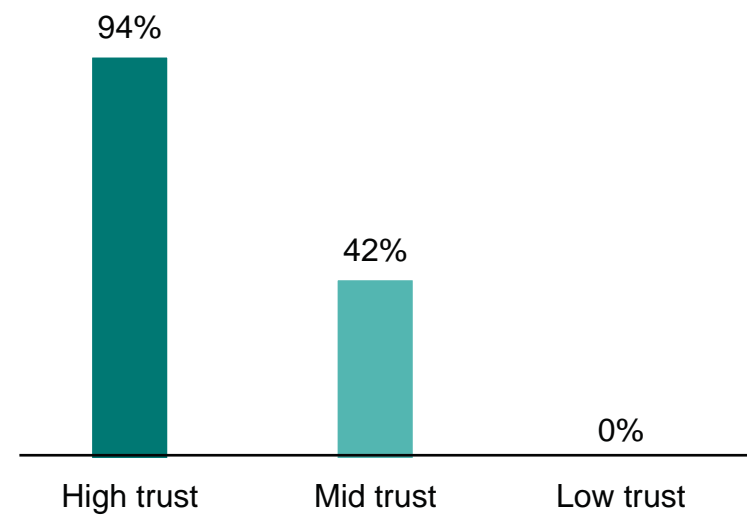
Source: Vanguard.

# Relationship management is business development

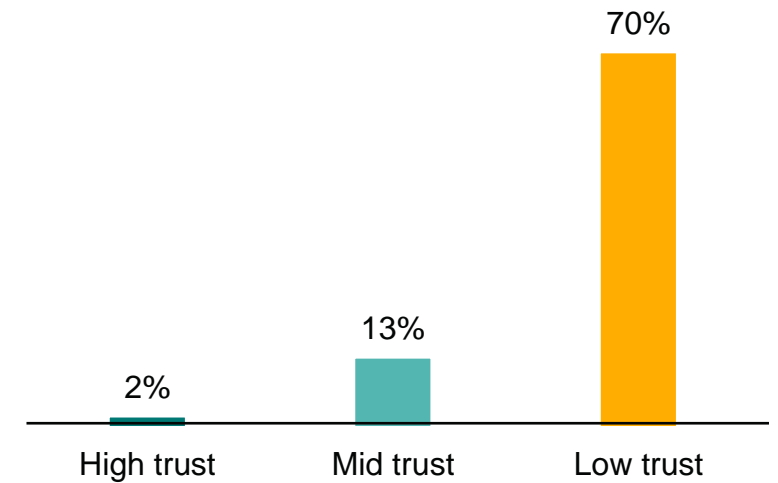
## How current advisor was found



## Extremely likely to offer referral



## Extremely likely or likely to switch advisors



Sources: Vanguard and Chadwick Martin Bailey, as of December 2016.

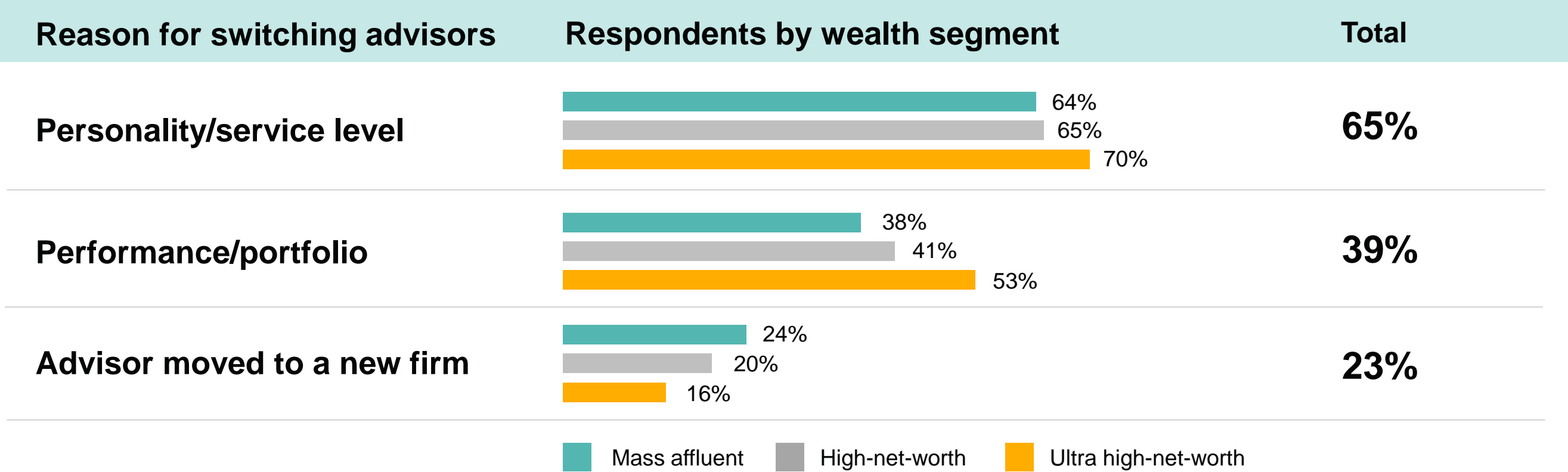
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# Relationship performance > Portfolio performance

- Clients evaluate their advisors more on their personality and service level than their performance
- Optimizing practice outcomes necessitates increased emphasis on relationship-oriented services



Sources: Vanguard and Chadwick Martin Bailey, as of December 2016.

# Vanguard Advisor's Alpha flywheel



Source: Vanguard.

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# Important information

**For more information about Vanguard funds or ETF Shares, visit [advisors.vanguard.com](https://advisors.vanguard.com) or call 800-997-2798 to obtain a prospectus or, if available, a summary prospectus. Investment objectives, risks, charges, expenses, and other important information are contained in the prospectus; read and consider it carefully before investing.**

*Vanguard ETF Shares are not redeemable with the issuing Fund other than in very large aggregations worth millions of dollars. Instead, investors must buy and sell Vanguard ETF Shares in the secondary market and hold those shares in a brokerage account. In doing so, the investor may incur brokerage commissions and may pay more than net asset value when buying and receive less than net asset value when selling.*

All investing is subject to risk, including possible loss of principal. Be aware that fluctuations in the financial markets and other factors may cause declines in the value of your account. There is no guarantee that any particular asset allocation or mix of funds will meet your investment objectives or provide you with a given level of income. Prices of mid- and small-cap stocks often fluctuate more than those of large-company stocks. Investments in stocks or bonds issued by non-U.S. companies are subject to risks including country/regional risk and currency risk. These risks are especially high in emerging markets. Funds that concentrate on a relatively narrow market sector face the risk of higher share-price volatility. It is possible that tax-managed funds will not meet their objective of being tax-efficient.

Tax-loss harvesting involves certain risks, including, among others, the risk that the new investment could have higher costs than the original investment and could introduce portfolio tracking error into your accounts. There may also be unintended tax implications. Prospective investors should consult with their tax or legal advisor prior to engaging in any tax-loss harvesting strategy.

Bond funds are subject to the risk that an issuer will fail to make payments on time, and that bond prices will decline because of rising interest rates or negative perceptions of an issuer's ability to make payments. High-yield bonds generally have medium- and lower-range credit-quality ratings and are therefore subject to a higher level of credit risk than bonds with higher credit-quality ratings. Although the income from a municipal bond fund is exempt from federal tax, you may owe taxes on any capital gains realized through the fund's trading or through your own redemption of shares. For some investors, a portion of the fund's income may be subject to state and local taxes, as well as to the federal Alternative Minimum Tax. Diversification does not ensure a profit or protect against a loss.

The Factor Funds are subject to investment-style risk, which is the chance that returns from the types of stocks in which a Factor Fund invests will trail returns from U.S. stock markets. The Factor Funds are also subject to manager risk, which is the chance that poor security selection will cause a Factor Fund to underperform its relevant benchmark or other funds with a similar investment objective, and sector risk, which is the chance that significant problems will affect a particular sector in which a Factor Fund invests, or that returns from that sector will trail returns from the overall stock market.

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# Important information (continued)

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