Slice of Advice: Behavioral Finance — The Psychology of Smart Money Moves

Introduction

Hello everyone, and welcome to our educational series, **Slice of Advice**.

My name is Rachel, and today we are going to talk about behavioral finance, or the psychology of smart money moves.

Our goal today is to answer a simple question: **Why do smart people behave differently with money?**

The perfect example is my own family. I am number five of seven kids. Yes, it's a lot, I know. Between the seven of us, we have two financial advisors, a CPA, a PhD, an orthodontist, a teacher, and a bookkeeper. That's a lot of smart people, if you ask me.

The other day, we all got together and started talking about retirement and saving for retirement. There is an 18-year gap between my oldest sister and my youngest brother, but our views on saving money and retirement were so drastically different that it blew my mind.

Even though we were all raised in the same house, by the same parents, in basically the same economic situation, we all felt very differently about what the future held and how we responded to money.

Today, I want to talk about how we can identify the traits and behaviors we have when it comes to money. Some of those traits can be awesome superpowers. Others might lead to a few problems that we need to recognize and potentially work around. I also want to touch on how we can interact with people who may have very different views about money than we do.

My goal is simply to educate so that we can learn a little more about behavioral finance, raise awareness of who we are, and learn how to better discuss finances. Obviously, as advisors, that's what we like to do. We want to help you have a better financial future.

The scientific term for what we're talking about today is **behavioral finance**. Essentially, it is the psychology behind what we think about money and our emotional and psychological connection to it.

The way we think and feel about money leads us to act in certain ways.

None of the behaviors we're going to discuss are inherently better or worse than the others. Just because you resonate with one more strongly doesn't mean it is the "right" behavior to have.

These are preferences. This is not a diagnosis. I'm not going to tell you what to do or who you are.

We do have a quiz called the **BFI-20**. It includes 20 questions covering five behavioral finance facets, and each facet has two polar ends. After answering the questions, you receive a result identifying the behavioral finance trait you most strongly align with.

But even as we go through this presentation, you may notice that you resonate with one side, the other side, or somewhere directly in the middle. That's okay. There isn't one that is inherently better or best. They all have strengths.

In general, there are five facets that help us differentiate how we behave toward money:

Communication, concern and worry, time value, responsibility, and importance.

I'm going to run through all five today.

Communication

The two ends of the communication spectrum are **direct communicators** and **indirect communicators**.

Again, one is not better or worse than the other, but it is important to understand your strengths and weaknesses when communicating about money.

Direct Communicators

Direct communicators generally believe money should be discussed openly. There's nothing wrong with talking about it, and there's no harm in discussing it.

They often have very clear opinions about how money should be spent, used, or saved.

These people can be very efficient in meetings. They will walk into a meeting with an advisor and tell you what they think, what they want, and what they need. That can make it very easy for an advisor to understand them, particularly if the advisor is also a direct communicator.

If you're in a relationship with a direct communicator, you might love how openly they communicate.

But there are a few pitfalls to be aware of.

A direct communicator needs to watch out for being too loud or overstepping in a conversation. The clear opinions they express may feel like criticism and can be hurtful to someone who doesn't share the same opinion or belief.

Interestingly, direct communicators can also feel a sense of fulfillment simply from having the open discussion. Sometimes they may forget to actually act on what was discussed.

If you're a direct communicator, find ways to create a list of action items or follow-up tasks so that you make sure the things you discussed actually get done.

Indirect Communicators

Being an indirect communicator doesn't mean that you don't have opinions.

Instead, you may believe that financial conversations should preserve privacy and harmony. They aren't meant to create conflict or cause one person to overstep another.

The conversation should be calm and thoughtful.

Indirect communicators tend to be careful when discussing things and may be more reserved.

That can be very useful in a conversation, but there are also a few things to watch for.

First, you may become avoidant. You may not want to discuss a difficult topic or address something that needs to change.

You might not voice your concerns because you don't want to disrupt the harmony or the system.

And if you are very reserved or quiet, other people, particularly direct communicators, may assume your silence means consent. They may think you agree with their opinion even when you very much do not.

Both communication styles have superpowers, as well as things that you need to recognize and potentially avoid.

Concern or Worry

Next is **concern or worry**.

The two ends of this spectrum are the **optimist** and the **pragmatist**.

I'm sure all of you have met someone who is generally an optimist in life and believes things will work out. The same can be true with behavioral finance.

The Optimist

If you're a financial optimist, you generally believe the money is going to work itself out.

These people tend to be calm. They are comfortable with risk because they believe things will work out in the long run. They're relatively confident and can be quite bold in the decisions they make because they believe those decisions are ultimately going to turn out in their favor.

What does an optimist need to watch out for?

First, you might miss problems. If you're so certain that everything is going to work out, you may not be actively looking for potential problems. You deal with them only as they arise, which can sometimes lead to poor planning.

Because an optimist is comfortable with risk, there is also a chance of losing efficiency.

We actually have technology that gives each investment a GPA. Think of a 4.0 as a perfect GPA. For the amount of risk you're taking, there is an expected amount of return.

Ideally, every investment would line up that way. But many times, you'll find an investment has a higher level of risk while still providing the same expected return as something less risky.

That difference represents an efficiency loss. You could potentially achieve the same return with less risk.

Ideally, you want that investment to line up at a 4.0 and become the valedictorian of investment strategies.

Optimists can sometimes take on more risk than necessary and miss out on those efficiencies. If you're going to take that much risk, you should be receiving a corresponding benefit.

Optimists may also forget to create a plan because winging it has always worked out before.

The Pragmatist

On the opposite end is the pragmatist.

These are the people you want with you on a road trip. They've got a backpack with Band-Aids, water, apples, Snickers, hand sanitizer, and baby wipes. They are prepared for everything.

When it comes to finance, a pragmatist tends to believe that we must anticipate and prepare for problems.

They notice risks. They may lean more heavily into insurance to make sure that anything bad that happens is covered. They are very prepared.

That can be incredibly helpful in financial planning, but there are pitfalls here as well.

First is **chronic planning**.

Sometimes you plan so hard and for so long that you never execute, or you miss your window of opportunity.

Because pragmatists are focused on preparing for the worst, they can also miss potentially better opportunities.

You might have a Snickers in your backpack melting away in the car while missing out on the Twix or ice cream bar at the gas station because stopping there wasn't part of your plan.

The same thing can happen financially.

Someone who is constantly preparing for disaster isn't necessarily looking for new opportunities and may actually miss them.

We see this when somebody wants their money to be so secure and so safe that they keep large amounts of cold, hard cash available because they know they're prepared for the apocalypse.

But if they had invested some or all of that cash in the market, they potentially could have earned more money on it.

Opportunity cost is always something a pragmatist needs to consider.

Time Value

Next, let's talk about **time value**.

This is one of the most important facets to discuss because people on opposite ends of the time-value spectrum can experience significant conflict. They think very differently about money and about spending money.

We joke as financial advisors that in most couples there is a saver and a spender.

For behavioral finance, we have a nicer name: **the saver and the savorer**, meaning someone who savors the money and the experiences it can provide.

Again, one is not better or worse than the other. You simply need to understand your superpowers and your potential pitfalls.

The Saver

Savers love seeing their 401(k) balance. They love seeing their retirement and savings accounts grow because money creates security and freedom, and that brings them joy.

Savers tend to be comfortable with delayed gratification.

They don't necessarily need the immediate dopamine hit. They get joy from seeing their savings grow, knowing they'll be able to do something with it later or knowing that they have protection against things that might happen in the future.

The risk is that they may never actually experience the joy they're delaying.

We never know what is going to happen in the future. While it's great to be protected and have security, if you never allow yourself to actually experience that fulfillment or joy, that can become a problem.

Savers tend to save consistently. They are often very independent and disciplined.

Those sound like perfect traits, but someone who saves consistently may also begin to distrust spending, even when spending is necessary.

It can almost hurt them to watch their money being spent or to see an account balance go down, even when what they're spending money on could bring them more joy or is something they genuinely need.

Because savers are disciplined, they can also get themselves into what I like to call a rut.

They want to continue doing what they've been doing for so long that, even when the red flags are waving and it's time to change, they can be very hesitant and struggle with the transition.

As financial advisors, we often see this when someone who has spent years working, accumulating, and saving transitions into retirement and begins spending that money for income.

It's already difficult to quit your job and retire. It becomes even more difficult when you also have to change your mindset about spending the money you spent years accumulating.

The Savorer

A savorer is not necessarily someone who is irresponsible.

In fact, savorers often hit meaningful goals more quickly than savers because they believe money is meant to help people enjoy life today.

These are the people who may spend their “play money” fairly quickly.

They connect money to experiences and enjoy the fruits of their labor.

They tend to set realistic goals that they know will bring joy. Because those goals are often shorter term and realistically achievable, they reach them fairly quickly.

There are still things savorers need to be cautious about.

First, don’t skip future preparation.

Just because you connect money to experiences doesn’t mean you can overspend what you have today.

There’s also the potential to skip financial planning because you think, “I just want to spend what I have. I don’t need to plan for the future.”

Most savorers are still setting goals, so there is generally some form of planning involved. But they may skip some of the future preparation they should be doing.

Interestingly, because savorers hit goals frequently and receive so much joy from achieving them, they can also struggle when a wrench gets thrown into the system.

If it’s a lean year and they need to slow down the progress toward their goals, they may feel very uncomfortable with that restriction, even when slowing down is necessary to create more joy and security in the long run.

Again, neither approach is better.

But because savers and savorers have such different mindsets about the actual spending and saving of money, we see some of the biggest financial conflicts between people who are drastically different in this area.

If you recognize yourself strongly in one of these descriptions, or recognize your spouse, friend, or advisor in one, make sure you’re able to communicate openly about it.

Explain why you feel the way you do. Try to understand and respect the other person’s emotions and reasoning.

Both people are smart. Both are consistently doing things and achieving goals. Both have strengths.

You simply need to understand your own pitfalls so that you and the person you’re discussing finances with can work together effectively.

Responsibility

Next is **responsibility**.

The two ends of this spectrum are the **protector** and the **giver**.

If you live in a very religious area and take the BFI-20, you may automatically score strongly as a giver. You might think, “I don’t actually focus on giving that much. It’s just been part of my life for so long,” or, “It’s simply something I’ve enjoyed doing for so long.”

There may not be a strong emotional connection to the financial act of giving. It may simply be part of who you are.

If that happens, you can take the BFI-20 again and perhaps answer the giving question less strongly.

However, if giving is important to you, that’s also great. Many advisors have discussed the benefits of giving and how it can affect you emotionally and mentally, as well as society as a whole.

Don’t feel bad or guilty if that’s who you are.

And if you’re a protector, that’s great too.

Again, neither is better.

The Protector

A protector generally believes that the responsibility to earn and manage money belongs to the individual.

The world doesn’t owe them anything.

They are very self-sufficient and often set strong boundaries around finances and money.

If you ask them for money and they tell you no, you’re probably not surprised. That is their boundary. They said no, and there generally isn’t further discussion, whining, or crying. That’s the answer.

These people tend to be very independent.

That can be a great trait, but there are pitfalls to be aware of.

First, you might be reluctant to accept help, particularly financial help.

If you believe, “Earning is my job. It is my responsibility to make money,” it can be very difficult to realize there are times when you may genuinely need financial help and to allow someone else to provide it.

Strong boundaries can also potentially hurt relationships or interfere with family or charitable goals.

If you've decided, "I only have this much available for giving," and someone asks you for help, you may simply say no even when helping them would be a meaningful opportunity.

With that independence and those strong boundaries, your response to money can sometimes feel like harsh judgment to other people.

Because you believe responsibility lies with the individual, a protector may judge someone who is in a less favorable situation.

That's simply something to recognize and be cautious of.

The Giver

A giver believes that money can and should support others.

These people tend to be generous. They believe wealth can be a tool for creating a positive impact on society and isn't simply their responsibility to accumulate.

Givers often associate money with legacy and relationships.

Those are wonderful things, but there are potential pitfalls.

A giver may forego their own emotional or financial needs.

They can give so much that they no longer have the assets or ability to cover themselves.

Sometimes they may think, "That's fine. If I'm a giver, somebody else is a giver, and someone will give to me."

That doesn't always work, particularly if you happen to be surrounded by protectors.

Givers may also struggle with saying no or turning people down. They may give gifts out of guilt rather than because giving was part of a thoughtful financial plan.

A great example of why we aren't always simply one type or another comes from my husband's grandma.

We were living rent-free in a little basement apartment in her house while we were very poor and very broke.

At the time, Sean, my husband's cousin, came to Grandma and asked whether she would loan him, I think, $3,000 or $4,000 to get his next certificate.

Grandma had plenty of money. Giving him the money wouldn't have been an issue for her.

I was kind of eavesdropping through the floorboards and heard their discussion.

She asked him, “Okay, do you have other certificates?”

He said, “Yeah.”

She said, “And you’re working full-time, right?”

He said, “Yeah, I’ve got a good job.”

She said, “But you don’t have the $3,000 or $4,000?”

He said, “Not really.”

She nodded and asked, “Well, how long would it take you to save up that $3,000 to $4,000?”

He said, “I think it would take me maybe three to six months.”

She asked, “Will the certificate course still be available in three to six months?”

He said yes.

So she told him, “Okay. How about this? You save for three to six months, and if you don’t have the money by six months, I will loan you the difference.”

Wouldn’t you know it, within three or four months he had saved all of the money himself and was able to complete the certificate on his own.

Was she a giver? Yes. She was still willing to give.

But did she also have boundaries? Absolutely.

We are not absolutes.

Human behavior changes depending on the situation, and it’s important to remember that the scale can slide back and forth.

You can be both a protector and a giver.

You can have boundaries while still caring about legacy, relationships, and sharing with others.

But you may find yourself strongly resonating with one side or the other, and that’s a great thing to learn about yourself.

Importance of Money

The final facet is the **importance of money**.

There are two ends of this spectrum: **minimizers**, who believe money is useful but isn't really part of who they are, and **maximizers**, who believe financial success is one of the most important things a person can achieve.

The Minimizer

A minimizer generally believes that wealth does not equate to character.

How much money you have or have accumulated doesn't necessarily say very much about who you are.

In general, these people don't care that much about money.

They focus more heavily on personal growth and values. They are less likely to compete financially.

They don't care what the Joneses have because they're not worried about the Joneses. The Joneses' money is their money, and what I make is what I make.

You'll often hear a minimizer say something like, "Enough is enough," or, "I have what I need."

They simply aren't very concerned about money.

That can be a great thing, but there are still potential problems.

They might avoid financial details because they just don't care that much about them.

They may end up carrying high-interest credit card debt because they didn't pay enough attention to how much interest they were being charged.

They may undervalue financial planning because they think, "It's not that complicated. I just don't care that much. It'll be fine. I'm much more concerned about who I am."

They may also struggle when discussing compensation or financial success.

This can be particularly challenging when a minimizer is a manager responsible for bonuses or raises.

The minimizer may not think there's a major difference between a $1 raise and a $3 raise because, from their perspective, you did a good job and deserve more compensation. Exactly how much more may not feel as important to them.

The Maximizer

A maximizer, on the other hand, may be thrilled about that additional $3 because financial progress was one of the goals all along.

Maximizers are often, although not always, wealth-motivated people.

They progress through measurable goals, and measurable goals can be very useful.

They often place specific financial goals on themselves, and hitting those goals is how they recognize progress and success.

These people tend to be ambitious.

The flip side is that they can develop a distorted idea of what “enough” means.

For a true maximizer, enough may never feel like enough.

They constantly want more and continually push themselves.

There may be no dollar amount where they finally say, “Okay, I’ve hit the mark. I’m good. I’m done.”

They set goals, but as soon as they hit one, they immediately raise the bar and start chasing the next big financial milestone.

They may also take unnecessary risks to get there.

Maybe they don’t need to work as much, push as hard, or take on as much as they are doing.

But after hitting step one, they may immediately want to jump to step five and believe the only way to get there is by taking additional risk.

And if you are entirely wealth-motivated, there can also be a danger in tying financial outcomes to your self-worth.

You cannot control every aspect of the market.

If an account balance drops significantly because of market movement and you connect that loss to your personal worth, that can become dangerous.

Again, most people are not at the polar extremes. Most of us fall somewhere along the spectrum.

But it is interesting and useful to understand whether someone is strongly motivated by financial wealth or less motivated by it.

Recognize, Respect, Respond

Overall, the reason I wanted to talk about all of this is because I want you to become more aware of yourself.

When you recognize your tendencies, you gain the opportunity and the choice to change.

You are no longer automatically ruled by an emotion or behavior. You can acknowledge it and intentionally decide whether to engage with it or choose a different route.

When we recognize and understand our tendencies, we can design around them.

As financial advisors, we love learning more about our clients so we understand where they naturally tend to go. If necessary, we can create a plan that helps circumvent potential potholes, slowdowns, or problems.

The concept is **recognize, respect, respond**.

When we recognize how we naturally respond, we give ourselves more options. We can respond intentionally, both as human beings and as advisors.

Understanding these behaviors also allows for a much greater degree of respect between people who share finances.

If you can understand and acknowledge how another person thinks about finances, the discussion becomes much less of an argument or conflict and much more of a mutual understanding of your differences.

That can make a world of difference, particularly when it comes to finances, which can be such a sensitive and private subject.

Learning more about yourself and the people around you can be incredibly helpful.

Disclosure and Closing

I do need to give an overall disclosure.

This is not specific personal client advice. I'm not telling you what to do or how to do it. This presentation is simply educational.

But I truly hope you take a moment to learn a little more about yourself, recognize your tendencies, and focus intentionally on what you can do.

If you're interested, we'll have a link available for the BFI-20. I'll admit, it's not a perfect link. Sometimes it works great and sometimes it doesn't.

But even if you simply begin figuring out where you fit within these different facets, share that information with your advisor.

If you don't have an advisor, find someone who is complementary to you. They don't have to be exactly like you, but find somebody who can help you understand where you are, what you're doing, and how to get to your end goals.

At the end of the day, that's what truly brings joy.

Maybe you experience that joy through a sense of security. Maybe you experience it through experiences themselves. Maybe you can communicate your feelings about money loud and clear, or maybe you can't.

Across all five of these facets, the goal of behavioral finance is simply to find more happiness, more joy, and more financial — I'm just going to say it — **financial bliss**.

If we can help you in any way, shape, or form, please reach out.

The telephone number is **208-552-9169**, or you can email the office at office@journeyretirement.com.

Thank you, and have a great day.