Think markets are moody? How about investors?

- Financial advisors may handle wild market swings like pros, but the same cannot always be said for their clients.
- Approaches to handling investors fears can include reframing the issue for worried clients, educating them about market dynamics and even imposing an informal news blackout.
- In rare cases, outside help from a therapist might even be warranted.

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Recent stock market swings in and out of correction territory despite overall good economic news have reminded investors that such wild volatility is always a possibility. While experienced financial professionals generally take such developments in stride, how can their clients protect themselves from their own emotional reactions?

The best way to avoid irrational decisions as an investor is to turn off the financial news, said certified financial planner Rick Waechter, founder of Old Peak Finance.

"Investing requires a long-term view," he said. "The news is by definition short-term, and there is no way to reconcile them," he said.

Waechter said that, at most, investors should look at their accounts monthly — and preferably less often. "Every six to 12 months, consider

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rebalancing ... to get back to your target risk level," he said.

Reframing

It's helpful to reframe situations for clients, advisors say.

"To encourage my clients to buy during down days or drops, I phrase it as 'The market is on sale,'" said Michelle Goldstein, a financial planner and owner of Goldstein Financial Future. "And who doesn't love a sale?

"A cumulative drop of 10 percent, like we had recently, means all your favorite funds are marked down 10 percent."

For his part, Aaron H. Parrish, CFP and vice president and senior financial advisor with Triad Financial Advisors, said he frequently encounters "anchoring bias" with clients who are reluctant to sell an instrument because it is trading lower than the purchase price.

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"My way to help people avoid emotions and think clearly about the situation is to ask, 'If you had the money in cash right now, would you buy that stock?'" he said. "By framing it that way, people let go of what they previously bought the stock at and realize there may be a better use of that money.

"I also run across this when discussing surrendering a permanent life insurance policy that doesn't serve a purpose anymore."

Behavioral approaches

"I don't think it's the client's responsibility to protect themselves from irrationality," said Paul Winter, CFP and president of Five Seasons Financial Planning. "In my view, it's part of our job as financial advisors to protect clients from [themselves], a big part in times like these." The first step for investors is to admit to themselves that they will likely behave irrationally when it comes to their own investments and financial decisions, he said.

"Given all the research and academic work on behavioral economics and behavioral finance, this seems fairly indisputable," Winter said.

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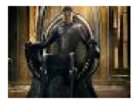

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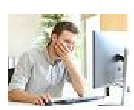

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The next step is for them to work with an advisor whose experience, business model, training and education allow clients to believe absolutely in their advisors' objectivity and professionalism in managing their portfolios, he added.

"There is no behavior that is irrational around investing when we understand [clients'] underlying thoughts and beliefs," said Rick Kahler, CFP, owner of Kahler Financial Group. "Every action may not be in our best interest, but it does make perfect sense when we understand what's behind it."

Getting facts straight

Helen Modly, CFP and wealth advisor with Buckingham Strategic Wealth, provides some facts and figures to help combat clients' irrational fears.

"Human beings are not wired to be patient, long-term investors," she said. "We are wired to respond to anxiety and fear by fighting or fleeing.

"Since there is no way to proactively 'fight' a down market, the urge to flee and protect our money becomes almost overwhelming," Modly added. "We must recognize this anxiety for what it is, a physical manifestation of an emotional response."

Here is some of the information she shares with clients:

• According to research from American Funds, all markets experience regular volatility, as follows:

° 5 percent market corrections occur about three times a year.
° 10 percent market corrections occur about once a year.
° 15 percent market corrections occur about every two years.
° 20 percent market corrections occur about every three and a half years.
° No one can predict when a correction will occur or how long it will last.

• Historically, bear markets are shorter than bull markets, as illustrated by First Trust.

• A large proportion of the total return of stocks over long periods comes from only a handful of days, according to a report by Dimensional Fund Advisors.

Once we become aware of these unconscious thoughts and beliefs, about 20 percent of the time, we can change them cognitively, he said.

"For example, we may not have enough of our portfolio in equities to meet the return we need for our retirement goal," he said. "Once we understand the underlying belief is that, for example, the stock market is the same as gambling and we receive some information about how stock exchanges work — that the worst decline in any one year is 55 percent, markets tend to go up over a long period of time, etc. — we may be able to change our asset allocation into one that's heavier in equities."

However, the other 80 percent of the time, the additional information does not change the behavior, Kahler said, which means that the underlying thought and belief has either not been uncovered or modified.

"In that case, a person needs to go deeper into what has created the emotional block," he added. "Psychologists call that finding the unfinished business. It usually takes working with a financial therapist to solve that puzzle."

— By Deborah Nason, special to CNBC.com

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