When your clients say they can't stomach stocks

Financial advisers say it's crucial to get investors to stay focused on diversification, dividends and their long-term goals

Jul 26, 2016 @ 12:01 am

+ Zoom

In this stock market, the biggest challenge for advisers isn't stopping clients from taking big fliers — it's getting them to invest enough in stocks to meet their goals.

It's rare that a stock market rally has been so hated. The Standard and Poor's 500 stock index has gained 17.5% since January 2014. Yet investors have yanked an estimated $84 billion from U.S. open-end stock funds and exchange-traded funds since then, according to the Investment Company Institute, the funds' trade group.

It's not that investors hate all investments: They have poured $244 billion into bond funds and ETFs during the same period. But stocks? Not a favorite. The American Association of Individual Investors' member poll for the week of July 20th had just 35.4% of their members bullish, which is well below the historical average of 38.5%. The survey has been below average for 37 consecutive weeks and 70 weeks out of the past 72 weeks.

Doug Ramsey, chief investment officer for the Leuthold Group, said his composite indicator of 35 investor sentiment indicators is “very subdued,” although he cautions against measuring current market sentiment against, say, the raging frothiness of the 1990s. “That was a once-in-a-lifetime mania,” he said.

In the upside-down world of investor sentiment, low sentiment is a bullish indicator: The majority of investors are wrong at major market turns. For someone like Mr. Ramsey, the challenge is when to interpret bearish sentiment as a bullish indicator. (Hint: Only at extremes).

For financial advisers, however, the challenge is how to deal with clients who simply want to get out the market and abandon their asset allocation because they're afraid of what the future will bring. Some of those worries could well stem from the perception that this is a dangerous and uncertain world, says Cary Carbonaro, a financial planner in Clermon, Fla., and author of The Money Queen's Guide: For Women Who Want to Build Wealth and Banish Fear.

“My experience has been the uncertainty of the election and all the negative news in the world. For example, Brexit and ISIS are making clients worried about the stock market. Clients are concerned with the unpopular candidates running," Ms. Carbonaro said. "There is a lot of fear out there right now."

Valuations are a worry to clients as well. “It's likely that investors are bearish due to current market valuations as well as corporate earnings prospects. Both the PE ratio and the Shiller PE ratio (inflation adjusted earnings on a 10 year average) are both nearly 200% of their median value,” said John Fowler, a financial planner in Dallas. “This doesn't mean that multiples can't expand further but it does mean that prudent investors should be looking for ways to raise cash, set stops, or use options and futures to hedge against a market drop.”

But that doesn't entirely explain the market's unpopularity. In the past 16 years, investors have endured the two worst bear markets since the Great Depression, a near-catastrophic financial collapse in 2008, and turmoil in Chinese and European stock markets. And all of those events may have left a long-term scar on investor psyches.

“Ever since the financial crisis, more of our people have had muted expectations from the stock market,” said Mark Bass, a financial planner in Lubbock, Texas. In the best case, that means toning down risk exposure, especially for those who are withdrawing money, rather than saving for retirement. “In the last few years, we've had more and more folks say, 'I don't need these stocks, just be sure we're in something that pays a dividend,'” he said.

Unlike the halcyon days of the 1980s and 1990s, the difficult part of talking with clients about their stock allocations isn't getting them to curb their enthusiasm, but to prevent them from selling their stocks entirely. “The tough part isn't increasing allocations,” said Barry Glassman, a financial planner in Vienna, Va. “Our job is to keep from panicking and cashing out.”

One strategy: Show clients the CNN Fear/Greed index, a composite sentiment indicator, Mr. Glassman said. It is currently registering “extreme greed,” a complete turnaround from a year ago when it was flashing “extreme fear.”

“It shows not only where we are currently, but the whipsaw seen in the past 12 months ago,” Mr. Glassman said. The chart lets them know that their own feelings about the market are normal.

The job then is to get clients ready financially or emotionally for the next downturn. One way is to point out what a 10% or 20% decline would do to their overall finances. “If they can't handle the downside, I'd rather they cash out now, than at the bottom,” Mr. Glassman said.

Another fallback, of course, is diversification. Clients are less concerned about a stock downturn when stocks are only a part of a diversified portfolio of bonds, foreign stocks and even commodities. “We keep folks pretty spread out anyway," Mr. Bass said. In that case, the talk is less about "Why am I in stocks?" than "Shouldn't we be leaning more towards value than growth stocks?" And if that's the case, "We'll have that conversation," he said.

Diversification didn't help much in 2015, which sported weak markets across the board. However, it has worked nicely in 2016, as emerging markets and bonds have all rallied, Mr. Glassman said.

But most advisers agree that it could be some time before they have to worry about clients jumping into a stock bubble.

"I feel that 2008/2009 created a sea change in investor attitudes and that what we are seeing now is probably a bit more lasting," said Elliot Herman, a financial planner in Quincy, Mass. "The good news is that the markets like to climb the wall of worry and thus the equity premium lives. I believe, faced with limited choices elsewhere and what has been remarkable market resilience, it is unlikely that investors will abandon equities as they remain among the better options over the long run."

1