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Using Wealth Way to address behavioral biases

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Benjamin Graham—one of the best-known investors of the last century—observed that "The investor's chief problem— and even his worst enemy—is likely to be himself."

Investors overtrade, chase returns, panic, and generally buy high and sell low—and these irrational behaviors can lead to significant underperformance.

Investing is a deeply personal undertaking, which is why we always start with a discussion about what's most important to you. With a deep understanding of your values and your goals, we can help you shape your wealth strategy and organize your investments to align to your definition of financial and personal success.

The goal of the UBS Wealth Way framework* is to help families understand how their assets can best be used to meet their objectives. This purpose-based approach uses three strategies to organize your investments so that you always know where your money is—and why:

- A **Liquidity** strategy to help maintain your lifestyle.
- A **Longevity** strategy to help improve your lifestyle.
- A **Legacy** strategy to help improve the lives of others.

This plan provides a disciplined investment approach that can help to minimize the risk related to costly emotional behavior by addressing key behavioral biases. For example:

1. **Myopia and loss aversion bias.** "Loss aversion" is a behavioral bias that acknowledges that most of us feel the pain of losses about twice as powerfully as we experience the pleasure of gains. The effect of loss aversion can be supercharged

when it's combined with the fact that losses are much more common over short holding periods; for example, the S&P 500 has fallen in about 46% of all daily returns since 1945, but only 36% or monthly returns and only 7% of all five-year returns. By dedicating the Liquidity strategy to provide for a family's short-term cash flow needs—and investing these resources to prioritize capital preservation—families should be able to focus on their long-term goals and confidently stay invested because they know that they have adequate resources to cover their short-term needs.

2. **Mental accounting bias.** Investors often feel more comfortable thinking about their wealth in "buckets," treating some dollars differently than others. This tendency can make it more difficult to make decisions that are rational in the context of the "big picture." For example, we tend to spend a larger share of income that comes in the form of an unexpected "windfall"—such as a tax refund or a bonus—than income that we are expecting.[1] By segmenting wealth by purpose, the Liquidity. Longevity. Legacy. framework aims to harness the mental accounting bias to help families make rational decisions more intuitively. It also helps to put returns into the context of the funds' purpose, which can help to make it easier to avoid the urge to panic sell and to take advantage of market declines (e.g., by rebalancing and accelerating dollar-cost averaging strategies with assets earmarked for long-term goals).
3. **Recency bias.** Harry Markowitz once noted that "The chief problem with the individual investor: He or she typically buys when the market is high and thinks it's going to go up, and sells when the market is low and thinks it's going to go down." Chasing performance is tempting, but it can be quite damaging for investors. For example, looking at the annual returns of 14 major asset classes since 1999, the prior year's best-performing asset class has had a roughly 40% chance of experiencing a loss the next year, versus 27% for a randomly chosen asset class and 31% for a well-diversified portfolio. Rebalancing— selling the recent best-performing asset classes to add to other asset classes—feels counterintuitive due to recency bias, but it can help you to prevent your portfolio from "drifting" into an allocation that you never intended.

The Liquidity. Longevity. Legacy. framework isn't a panacea for solving our emotional biases, but it does provide a concrete framework for decision-making that you can fall back on during times of market stress.

Since first introducing this framework a decade ago, we have used it to help hundreds of families. Both in theory and in practice, this approach helps families to better understand their personal situation, uncover new goals and opportunities, and make better decisions over their lifetimes.

Through this process—and the plan we create together—our unique wealth management approach will help give you the confidence that you have all you need—for today, for tomorrow, and for generations to come.

To learn more about Wealth Way, see **A purpose-based approach to managing your wealth**, published October 2024.

*Understanding your life, your wealth and what you want to accomplish is how we work together. UBS Wealth Way is an approach that incorporates three key strategies: Liquidity. Longevity. Legacy. Looking at your wealth in this way can help you pursue your financial goals in the short term, long term or whatever your terms may be. Of course, there are no guarantees that you'll achieve wealth, or any financial results. All investments have risk, including the potential of losing the whole investment. Talk to your UBS Financial Advisor about your feelings around risk.

[1]Thaler, R. H. (1990). Anomalies: Saving, Fungibility, and Mental Accounts. Journal of Economic Perspectives, 4(1), 193-205.

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