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Herd instinct points the way: financial advisors

- **Simon Hoyle**

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ONE result of the global financial crisis was a drop in the confidence of individual investors in financial planners and fund managers.

In the immediate aftermath of the financial meltdown, key pieces of local research -- most notably by Endgame Communications and Investment Trends -- identified a big drop-off in the number of investors who said they would use the services of fund managers and financial planners in future.

Understandably, a large proportion of people were questioning what planners and professional fund managers were good for, if they could neither foresee the GFC nor protect investors against it when it happened.

But with the passage of time, new research seems to indicate that investors are again seeking professional advice to guide them, at least when it comes to making share investment decisions.

The second CMC Markets Share Trader Insights Survey has identified a modest recovery in the number of direct share investors willing to seek advice before making decisions to buy or sell.

David Land, chief market analyst for CMC Markets Australia, says the recovery of trust in professional advisers is to be expected, given what we know now, but didn't fully appreciate at the time, about the causes and the scale of the GFC.

The proportion of share traders who said they were exclusively self-directed -- that is, they did not seek advice -- fell by three percentage points, from 78 per cent to 75 per cent. Conversely, the proportion of traders who sought advice increased from 22 per cent to 25 per cent.

Land says key sources of advice include full-service brokers and financial advisers. "The first survey we ran was just post-GFC," he says. "And we saw this great movement away from financial advice.

"I don't find it surprising to see a move back towards financial advisers. As the reality of the situation and the depth of the situation has become apparent and more understood by people, there's less anger directed towards intermediaries."

Even though traders are more inclined to seek advice, the CMC research has revealed that traders still tend to behave as a herd.

Perhaps flock is as good a term; in the original Wall Street, Gordon Gekko described investors as sheep.

"And sheep get slaughtered," he observed.

"This is a survey that looks at 500 nationally representative people who fall into the more active traders end of the market," Land says.

"It's people who are taking a fairly active approach to their investments."

"What we've been able to do this time around is come up with what we've tagged the CMC herd index, [which measures] how people move in their overall level of optimism or pessimism.

"One of the things that's really interesting is the timing in relation to where the market is going. We can see a tendency for people being most optimistic, and doing most of their buying, around the zenith of a bull market phase; and doing most of their selling, and being most pessimistic, just after a bear market phase."

In other words, the herd index may prove to be an indicator of the likely future direction of the market: when it measures high levels of optimism, it could be telling us the market is near a peak. And vice versa: when the index indicates that pessimism is at its peak, we may be near a market trough.

"You have to bear in mind that at [any point] you can never tell what is going to happen next," Land says.

"But there is this tendency for people to act as a bit of a group there."

The herd index is showing a lower level of optimism now than in CMC's previous survey, but "we've still got more optimists than pessimists at the moment".

Land says share traders are also hungrier for information.

They scour "the full gamut of things" in their search for better information on which to base decisions, "from internet chat boards to traditional book learning".

"That's a trend that's set to continue," according to him.

Land says active traders need to look at any trade from two perspectives: what (and when) to buy, and "the terms under which they are going to exit the position".

Another key finding of the CMC research is how so-called ESG considerations -- environmental, social and governance -- are beginning to inform traders' decisions.

Land says there's mounting evidence that ESG issues are playing a role, but it's not clear that all investors are equally influenced, or that all investors apply rigorous ESG analysis.

For example, the CMC market found traders perceived Westpac to be among the least ethical Australian banks, yet Corporate Monitor ESG Research Ratings ranks Westpac as the country's most ethical bank.

"People may have a perception of the ethical standing of a company, but it may not be in line with the reality of the situation," Land says.

Land says there are generational issues, too: baby boomers are likeliest to be influenced by (real or perceived) ethical considerations; generation Y investors are least likely. Generation X investors fall somewhere between the two.

Simon Hoyle is editor of Professional Planner magazine
