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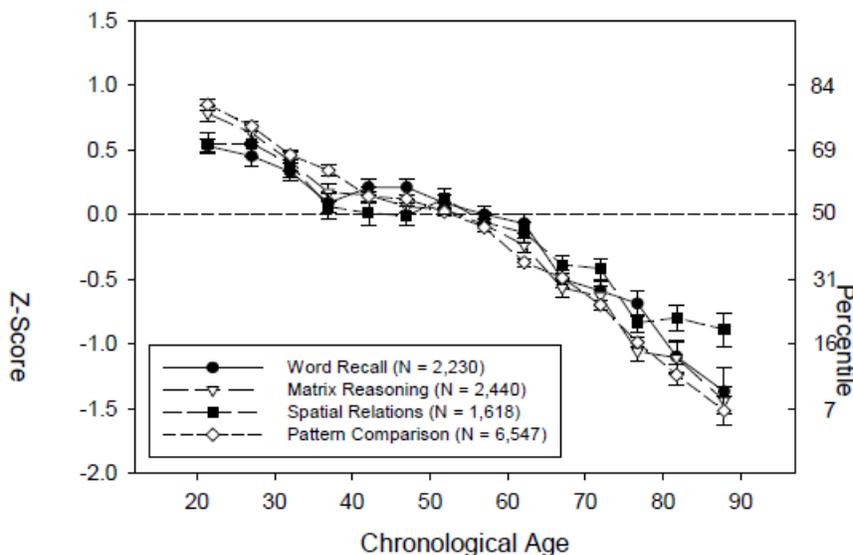
### Baby Boomers and the Need for a Trusted Advisor

Recently my wife and I took her father on a cruise. He has an interesting habit—he likes watching people gamble, but never wanted to be one of them, not even with others’ money. We tried handing him a \$20 bill and convincing him to play for fun, but he just would not. I could not help but wonder if that is simply his personality or could there be other factors causing his risk-averse attitude toward a harmless game.

Coincidentally, The Journal of Financial Planning (JFP) recently published an in-depth article on aging and its impact on retirement income decision making<sup>1</sup>. One interesting statistic shows that retirees, like my father-in-law, can be “five times more loss averse than the average investor.” Even more, half of them would pass on a gambling game which would have a 50% chance of winning \$100 and a 50% chance of losing \$10. No wonder he would not take our offer!

Why is that? Why do the elderly display a higher risk aversion profile? Like everything else, the human body is subject to wear and tear. Our intricate brain is no exception. Analytical skills responsible for decision making peak at around age 50, as a result of ample life experience and still-strong analytic cognitive function. However, researchers have shown that such function begins to decline at age 20 (see Figure 1).

**Figure 1: Decline in Analytic Cognitive Function over Time**



Source: Agarwal et al. “The Age of Reason: Financial Decisions over the Life-Cycle with implications for Regulation.” Brookings Papers on Economic Activity (October 19).

What is of greatest concern to us is that often the increased risk aversion manifests itself as an increased tendency to “transfer decisional authority to a perceived ‘expert’ with little

<sup>1</sup>Kasten, Gregory and Michael Gregory. 2011. “The Impact of Aging on Retirement Income Decision Making.” *Journal of Financial Planning* (June).



independent thought,” writes Dr. Gregory Kasten in the JFP article. This increased tendency, combined with decreased decision making ability, subjects older people to possible manipulation and financial exploitation of by ill-intentioned people.

With over 40 million of the population over 65 years old<sup>2</sup> and 10,000 becoming eligible for Social Security and Medicare every day<sup>3</sup>, financial fraud targeting seniors is poised to proliferate.

Every advisor has, at one time or another, seen an elderly client, who is relatively “financially illiterate,”<sup>4</sup> being sold financial products that are outside of their comprehension and interests. Investing in something without fully understanding the structure of the investment could lead to unexpected costs and consequences.

There are probably more financial products than items in a Wal-Mart store. The general public deserves and needs to understand what they are getting into. Having an independent advisor, who knows and understands both the individual and their portfolio as a whole, is a good way to avoid these issues. In fact, many fraudsters will immediately disappear if they are told that you need to review the product with your financial advisor<sup>5</sup>.

As your advisor it is our fiduciary responsibility to reveal any negative attributes and potential problems with an investment you might be interested in and to provide you with as much education (in laymen’s term) as possible so that you can help out friends and family members, and help prevent others from falling victim too. Both the CFA Institute and the CFP Board have very rigorous ethics code and professional conduct guidelines to ensure the highest possible integrity from their members. In other words, you are in good hands.

As always, give us a call anytime with your questions and comments.

Happy summer!

- Henry Yu, CFP®

***Simple but useful questions to ask when you’re offered a financial product:***

- 1. What are the commission or sales loads schedules?*
- 2. How quickly can my funds be available?*
- 3. Is there a prospectus or brochure I can take with me to discuss this investment with my financial advisor?*

<sup>2</sup>2010 Census Briefs. <http://www.census.gov/prod/cen2010/briefs/c2010br-03.pdf>.

<sup>3</sup>The Demographics of Aging. <http://www.transgenerational.org/aging/demographics.htm>.

<sup>4</sup>Lack of knowledge in 1) compound interest, 2) inflation, and 3) risk diversification.

<sup>5</sup>Patterson, Robert. 2011. “Protecting the Elderly from Financial Fraud.” *CFA Institute Magazine* (July-Aug).