# Social investing: behavioral insights for the modern wealth manager

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EY

**Building a better working world**

Investors are no strangers to volatility – from the 1637 Dutch tulip speculation to the late '90s dot-com bubble – and one of the key influences has always been communication between investors. Market opinions, discussed through any channel, work to prime others towards similar investment behaviors, which may lead to markets observing increased volatility.

As peer-to-peer investor communication proliferates through digital channels, the new era of social investing represents both a key opportunity and a key challenge for modern wealth managers.

# 01 What is social investing?

Historically, the notion of discussing personal finances with anyone other than an investment professional was considered taboo. However, with only 28% of millennials trusting banks and financial institutions, according to the World Economic Forum, younger generations are flocking to social media apps and forums to discuss investment and trade ideas.

*Social investing occurs when individuals seek investment recommendations from friends, family and similar others, leveraging collective knowledge to make investment decisions.*

As the wealth gap has continued to grow wider this century, everyday investors have begun to look for alternative, non-traditional channels for advice and guidance. Coupled with recent trends to democratize and digitalize finance, it's easy to see that social investing is here to stay:

1. **Digital availability** – A new generation of investors now have access to financial markets via digital brokerage apps – which aim to make investing more fun and simpler. As of 2018, 69% of adults have access to financial markets globally, a whopping 51% increase since 2011.

2. **No-fee trading** – As a result of intense competition and new market entrants, trading fees at brokerage firms have been all but eliminated.

3. **Social media access** – Internet forums and social media apps have given the collective masses the ability to communicate at a scale never-before seen. Today, over 4.1 billion people use social media globally.

While social investing can take many different forms, some of the key features include:

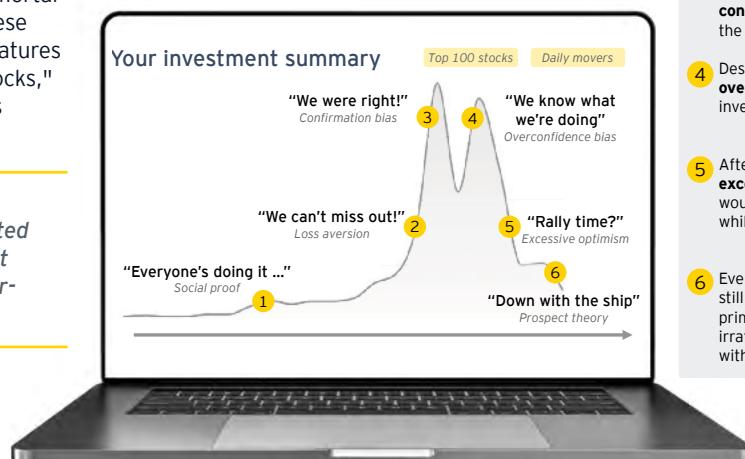| Follow & Subscribe | The ability to follow live, real-time trades from investors (both professional and amateur) across the globe |
|---|---|
| Peer-to-Peer Chats | Group chats and forums among like-minded investors in which investment strategies and trade ideas are discussed |
| Video Streaming | Live broadcasted videos in which investors discuss market opinions and investment ideas |

# 02 A new kind of volatility

The rise of social investing over the past decade has led to a new phenomenon: social volatility. Emerging social and investment technology platforms have accelerated both the speed and impact of market fluctuations.

In early 2021, investors on the social media site Reddit banded together to artificially drive up the stock price of a brick-and-mortar video game dealer by over 1,800%. These social investors used follow and chat features to create a boom in multiple "meme stocks," a term which has come to define stocks targeted for social volatility.

*Social volatility occurs when investors use social platforms to make coordinated investment decisions that drive market fluctuations at a speed and scale never-before seen.*

While social investing has led to this new form of volatility, the underlying investor behavior is no different – subject to both individual and group biases and blind spots that heavily influence behavior. To illustrate this, we highlight the behavioral phenomena at play along a price chart of one of the stocks that investors targeted in early 2021.



Your investment summary — Top 100 stocks — Daily movers

"We were right!" *Confirmation bias* ③
"We know what we're doing" *Overconfidence bias* ④
"We can't miss out!" *Loss aversion* ②
"Rally time?" *Excessive optimism* ⑤
"Everyone's doing it …" *Social proof* ①
"Down with the ship" *Prospect theory* ⑥

1. **Echo chambers** of online community boards and promotional campaigns for popular stocks (**social proof**) led to **groupthink** and amplified trading activity across securities that had no fundamental changes to value.

2. Investors tend to view missed opportunities as a loss, which is known to generate stronger reactions than equivalent gains. This **loss aversion** caused many investors to blindly invest for fear of missing out.

3. As the price of meme stocks soared, investors began feeling validated in their investment decisions. This **confirmation bias** led investors to continue touting the stocks on social media.

4. Despite an initial dip in price, investors began to feel **overconfidence bias** take control as a new surge in investment pushed the meme stocks up once again.

5. After another large dip, retail investors displayed **excessive optimism** and assumed their investments would rally once again, keeping trading volume high while the price was in free fall.

6. Even though investors' unrealized losses soared, some still continued to hold instead of cutting their losses, a prime example of **prospect theory**, in which investors irrationally display risk-seeking behaviors when faced with potential losses.

# 03 Designing for social investing

With social investing here to stay, modern wealth managers must be prepared to capitalize on the budding opportunity while balancing the fine line of protecting individual investors without restricting any freedoms.

Key questions firms should consider as they develop social investing operating models:

1. What key features of social investing should be offered by the modern wealth manager?

2. How can firms identify securities being influenced by social volatility in real time, and what role should this data play?

3. How can firms ensure that investors are equipped with relevant trading information while not priming the user towards a certain decision or limiting individual freedoms?

To answer these questions, wealth management firms need to understand how their client segments are influenced by digital design and choice architecture. Firms can achieve this by using one of the many established behavioral science frameworks to design evidence-based interventions, or "nudges," as they are commonly called.

Below, we use the MINDSPACE framework (Dolan et al., 2012) to provide a more rigorous breakdown of how firms can use behavioral science to help answer these key operating model questions. MINDSPACE summarizes nine of the most robust and influential automatic effects on human behavior.

| | MINDSPACE cue | Example questions |
|---|---|---|
| **M** | **Messenger**<br>We are heavily influenced by who communicates information | ‣ Where do each of our client segments tend to seek investment information?<br>‣ Which segments are more likely influenced by perceived experts vs. social networks? |
| **I** | **Incentives**<br>Our responses to incentives are shaped by predictable mental shortcuts, such as strongly avoiding losses | ‣ What structural incentives (monetary and non-monetary) are in place that influence client investment decisions?<br>‣ What, if any, incentives have been designed to encourage client financial literacy and understanding of investment risks? |
| **N** | **Norms**<br>We are strongly influenced by what others do | ‣ Has the design of our trading platforms intentionally or unintentionally influenced client trading behavior?<br>‣ Are our clients making investment decisions based on perceived social benefits or penalties? |
| **D** | **Defaults**<br>We "go with the flow" of preset options | ‣ Do our default option sets protect new investors or put them at risk?<br>‣ Are simplified user flows optimal for all of our user segments? |
| **S** | **Salience**<br>Our attention is drawn to what is novel and seems relevant to us | ‣ To what degree should we use active choice to confirm user investment intentions?<br>‣ What is the optimal balance of forewarning effectively without restricting freedom? |
| **P** | **Priming**<br>Our acts are often influenced by subconscious cues | ‣ What words, sights and sensations exist within our platform today that influence investment behavior?<br>‣ What subconscious cues can be designed to inform investors of risk without limiting freedom? |
| **A** | **Affect**<br>Our emotional associations can powerfully shape our actions | ‣ What images, events and stories trigger automatic behaviors with our client segments?<br>‣ How can we help clients identify these emotional triggers and help to debias them before making trading decisions? |
| **C** | **Commitments**<br>We seek to be consistent with our public promises | ‣ What role are commitments playing with our existing client base that may be driving certain trading behavior?<br>‣ How can we leverage commitment devices to help clients behave in ways that are consistent with their intentions? |
| **E** | **Ego**<br>We act in ways that make us feel better about ourselves | ‣ How is perceived self-image influencing client investment behaviors?<br>‣ What steps can we take to acknowledge and reward users for behaving in ways that uphold their own beliefs? |

# 04 Moving forward

We have a team of behavioral finance professionals focused on these questions and many more. The EY team would be happy to speak with you about applying cutting-edge behavioral insights to improve outcomes across client acquisition, engagement, retention, and risk.

Our core behavioral offerings include:

1. **Current State Behavioral Appraisal** – Review existing copy and design to identify behavioral bottlenecks and conduct behavioral science literature reviews to provide recommendations

2. **Behavior Design Methodology** – A structured workshop in which intended behavior sequences are mapped to defined business aspirations and outcomes with iterative testing to rapidly assess the psychology of an idea before development

3. **Behavioral Profiling Technology** – Assess the leading behavioral technology vendors to embed behavioral and psychographic profiling within your discovery and segmentation processes

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