

Right mindset, wrong market: Understanding investor decision- making and coaching for success

Summary

- The decision-making strategies we use to effectively navigate everyday life typically are not transferrable to making successful investment decisions.
- Past performance, relative ratings, and ranking systems, reliable predictors of outcomes in areas as inconsequential as where to eat, to the potentially life-altering decision of choosing a surgeon, have failed to produce similarly desirable outcomes when applied to investing.
- Embracing the behavioral coaching principles of planning, proactivity, and positivity sets the stage for advisors to deliver effective coaching when the opportunity presents itself in the moments that matter.
- Behavioral coaching is likely the single most important service advisors can provide to their clients and one of the most impactful drivers of practice outcomes as it strengthens trust between advisors and their clients.

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As humans, we like to think ourselves rational creatures.

We use our individual and collective experiences to hone our reasoning and decision-making, essentially creating mental shortcuts learned from things that occurred in the past. These past experiences help us to make sense of the various questions life poses, from the mundane, *what should I have for dinner?* to the complex and potentially life changing, *which surgeon should I chose for an upcoming procedure?* We are often faced with decisions and an abundance of options. Making sense of those options and finding the best choice to suit our desired outcomes is central to navigating our day-to-day lives. Investment decisions, much like life's quandaries, can similarly range from the seemingly insignificant, *which index fund do I purchase?* to the more complex and consequential, *how do I best maximize the after-tax returns of my portfolio?* Yet, the conventional process for how we make decisions over the course of our day does not necessarily translate

to success in our investment decisions. Why is that so? In the following paper, we will examine how our mindset in decision-making, although appropriate in many contexts, is not applicable to all environments or markets, particularly financial markets. There are those who say this is evidence of our irrationality; but we believe that we investment professionals, and clients alike, are indeed rational, and that understanding the investor mindset serves as the foundation to achieving better outcomes.

The premise of this research is twofold. First, we seek to answer the fundamental question: Why do investors behave the way they do? Second, we will introduce a framework to proactively leverage our knowledge of investor behavior to help improve decision-making and thus help improve both investor and advisor practice outcomes.

The right mindset:

A simple decision framework

A common, rational framework for decision-making, regardless of the magnitude of the decision, is characterized by a multistep process. This process typically begins with recognition of both a need and its importance, followed by gathering of data—for example, online data, consumer reports, or

conversations with trusted individuals (**Figure 1**).

The process then advances to evaluating options, weighing alternatives, and then, ultimately, making a choice. The final step, though often glossed over, is the post-decision period where one assesses the level of satisfaction derived from the outcome.

FIGURE 1.

Five-step rational decision-making process



Source: Vanguard Investment Advisory Research Center.

Today, the ability to source data to inform our decisions has been dramatically enhanced by the internet, offering a multitude of information sources that consumers tend to rely on and trust. Given the increased utilization of reviews, consumers have near real-time ability to assess the adequacy of a product or solution they are looking to acquire or utilize. In 2026, "97% of consumers read reviews for local businesses" and "the average consumer uses six different review sites when choosing a business." In addition, nearly half of consumers trust online reviews as much as personal recommendations from friends and family.¹ Rating services, consumer reviews, and the full utility of the internet, all would seem to enable individuals to make better decisions today than in the past.

Yet for a variety of reasons, even this simple framework can become unworkable. Information overload makes it hard for people to sift through what is relevant versus what is not. Confronted by seemingly endless data, they seek some type of shortcut to make an informed choice. (Note that these shortcuts are

themselves often accessed through the internet.) One such shortcut is to rely on rating services—in which "experts" or novice consumers use a formal rating system, typically based upon past performance, to report what other individuals are doing and saying (e.g., ratings of dishwashers in *Consumer Reports*). Another approach is to rely on numerical data that are widely available and disseminated—for example, data on the maintenance and reliability records of makes of automobiles, or in the asset management industry, past-performance data on investment products.

For numerous consumer goods, past performance or experiences can often reasonably be linked to future expectations. Performance ratings for goods and services as diverse as education, fine dining, and health care can share similar predictability and, therefore, reliability: An institution, product, or service that is highly rated one year will likely be highly rated the next year, and a below-average-rated institution, product, or service one year will likely be similarly rated the next.

¹ Rosie Murphy. *Local Consumer Review Survey 2026*. Brightlocal. <https://www.brightlocal.com/research/local-consumer-review-survey/>

Universities

For example, one of the best-known college ranking systems is *U.S. News & World Report's* "Best Colleges." This annual ranking allows users to compare the relative quality of institutions for higher education. When viewing college rankings from 2016 through 2025, we found that the top-10 yearly institutions changed little, as shown in **Figure 2**.

Unlike the lack of a pattern in sub-asset-class investment returns that we see next in **Figure 3**, here there seems to be a closer relationship in the absolute rankings from year to year. This indicates a very high

chance that a university that is highly rated one year will continue to be so rated the following year. In addition, of the schools rated in the last decade, most of the top 10 in 2016 remain in the top 10 in 2025. There have been some shifts over the course of the years, but the relative position and rank of the top universities in the country remains relatively consistent. It is important to note that these are absolute rankings, so quartile rankings would show even more persistence.

FIGURE 2.

Top-10 U.S. schools, as rated by *U.S. News & World Report*: 2016–2025

UNIVERSITY	'16	'17	'18	'19	'20	'21	'22	'23	'24	'25
Princeton University	1	1	1	1	1	1	1	1	1	1
Harvard University	2	2	2	2	2	2	2	3	3	3
Yale University	3	3	3	3	3	4	5	3	5	3
Columbia University	4	5	5	3	3	3	2	18	12	13
University of Chicago	4	3	3	3	6	6	6	6	12	6
Massachusetts Institute of Technology	7	7	5	3	3	4	2	2	2	2
Stanford University	4	5	5	7	6	6	6	3	3	3
Duke University	8	8	9	8	10	12	9	10	7	7
University of Pennsylvania	9	8	8	8	6	8	8	8	6	7
California Institute of Technology	10	12	10	12	12	9	9	9	7	11

Sources: Vanguard Investment Advisory Research Center, based on data from *U.S. News & World Report's* "Best Colleges" (2016–2025).

FIGURE 3.**No discernible pattern in the annual returns for selected market indexes: 2016–2025**

2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
12.68%	31.06%	3.16%	30.84%	20.99%	43.06%	13.75%	25.98%	23.77%	31.95%
11.77%	27.41%	1.86%	25.84%	15.51%	27.05%	1.50%	15.79%	11.63%	24.50%
11.40%	21.19%	–0.08%	21.80%	12.99%	25.72%	–12.72%	15.76%	10.71%	17.15%
8.60%	15.53%	–4.57%	20.41%	11.24%	10.69%	–13.07%	13.74%	8.75%	16.23%
7.05%	5.07%	–5.01%	19.79%	7.75%	8.84%	–16.07%	9.55%	5.52%	11.07%
4.90%	3.63%	–5.17%	8.87%	4.75%	1.48%	–16.10%	8.75%	5.45%	7.21%
4.72%	2.57%	–12.99%	8.06%	0.58%	0.05%	–17.58%	5.60%	3.79%	4.40%
2.75%	0.84%	–14.61%	5.44%	–3.50%	–1.58%	–19.49%	5.26%	1.33%	3.03%
0.27%	0.75%	–14.77%	2.25%	–7.57%	–2.10%	–24.51%	–12.55%	0.12%	2.95%

EM equities	REITs	Cash
U.S. equities	Commodities	U.S. bonds
International bonds	International equities	VGI 60/40

Sources: Vanguard Investment Advisory Research Center using data from CRSP, MSCI, FTSE, and Bloomberg.

Notes: U.S. equities represented by CRSP US Total Market Index. International bonds represented by Bloomberg Global Aggregate ex-USD Float Adjusted RIC Capped Hedged Index. REITs represented by MSCI US REIT Index. Commodities represented by Bloomberg Commodity Index. International equities represented by FTSE Global All Cap ex-US Index. Cash represented by FTSE 3-Month US T-Bill Index. U.S. bonds represented by Bloomberg Aggregate US Float Adjusted Bond Index. Emerging Markets index is a spliced index consisting of MSCI Emerging Markets Index Net USD through January 9, 2013; FTSE Emerging Transition Index through June 27, 2013; FTSE Emerging Index through November 1, 2015; FTSE EM All Cap CN A Trans Idx through September 18, 2016; and FTSE Emerging ACap CN A Incls Idx thereafter. The VGI 60/40 stock/bond portfolio is 60% CRSP US Total Market Index/40% FTSE Global All Cap ex US Index for the equity portion of the portfolio and 70% Bloomberg US Aggregate Float Adjusted Bond Index and 30% Bloomberg Global Aggregate ex-USD Float Adjusted RIC Capped Hedged Index for the bond portion.

Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

Not only is it the right mindset, it is the right market.

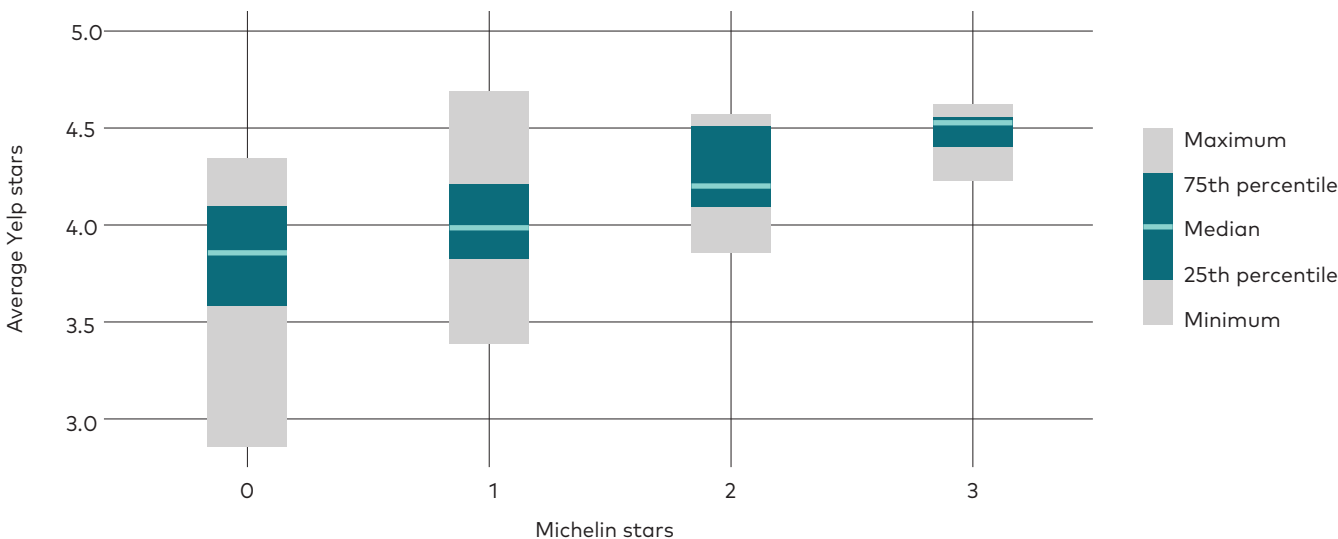
Fine dining

The fine-dining area offers numerous rating systems, each based on past performance and consumer experience, such as the *Michelin Guide*, *Forbes Travel Guide*, and *Zagat*. Although each of these guides has a different rating system and evaluation process, each provides a relative quality ranking of the establishments under review. As an example, we highlight here the New York City *Michelin Guide* ratings. Although these city ratings were launched only recently (first ratings were in 2006), the Michelin Star has long been a hallmark of fine dining around the world. The Michelin evaluations are entirely independent of the restaurants being observed, and they use anonymous inspectors who pay for their own meals and are encouraged to keep their occupation completely confidential even from their families. The reviewers focus primarily on the quality and consistency of the food. After a restaurant is evaluated, it is either awarded a rating up to 3 stars or not rated at all, defined by the Michelin Guide as follows:

- ★★★ Exceptional cuisine, worthy of a special journey
- ★★ Excellent cooking, worth a detour
- ★ Very good cooking in its category, a good place to stop on your journey

These stars are highly sought-after, and the vast majority of New York City restaurants receive no stars at all. Michelin stars are aspirational; their point-in-time evaluation process and award is generally indicative of a quality and elevated dining experience. As shown in **Figure 4** from the widely followed data blog, *FiveThirtyEight*, when the blog authors overlay Michelin ratings with that of the Yelp review system, a proxy for consumers' actual outcomes, they find that the median review tends to increase as the number of stars increase. Additionally, the experience tends to be superior within a very narrow range of dispersion, indicating strong predictive power and ongoing persistence.

FIGURE 4.
Michelin stars highly indicative of customer satisfaction



Source: Nate Silver. *Yelp And Michelin Have The Same Taste In New York Restaurants*. Fivethirtyeight.com, 2014.

Right mindset. Right market.

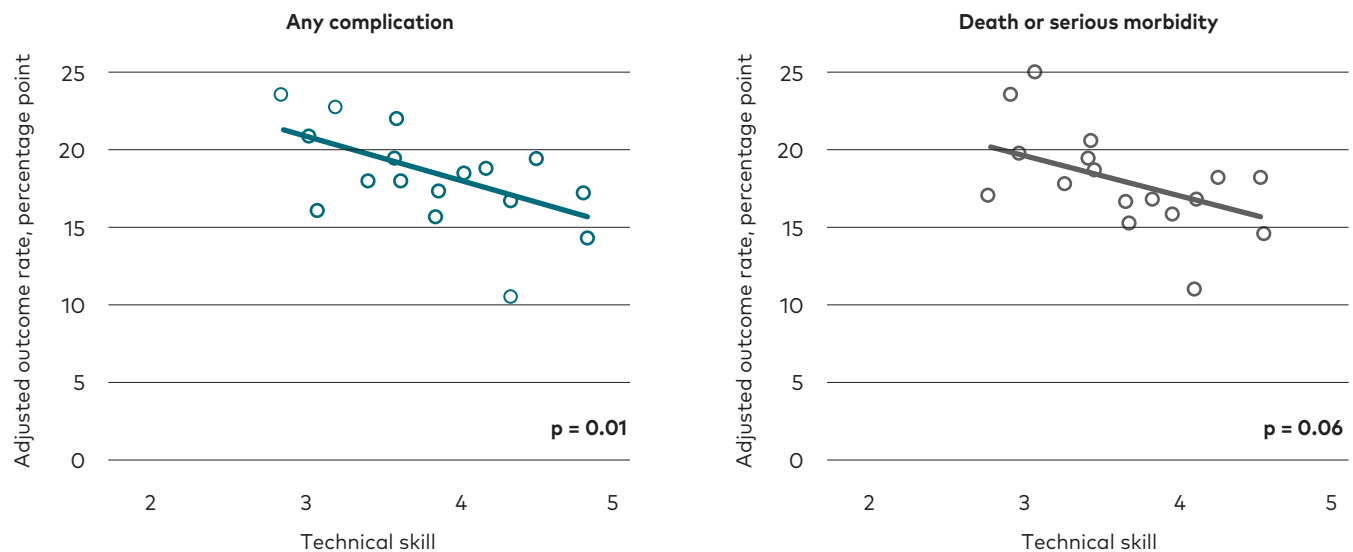
Surgeon selection

For the majority of us, the decision as to where to eat dinner is not life-or-death, but the decision regarding whom we select to perform a surgery may indeed have life-altering implications. There is an extensive body of research on the evaluation of medical professionals and subsequent surgical outcomes. One such recent

publication from the *Journal of the American Medical Association* (JAMA) examines the relationship between level of technical skill of a colorectal surgeon and the likelihood of a client developing post-surgical complications (Stulberg et al., 2020).

FIGURE 5.

Association between surgeon technical skills and patient outcomes



Source: Jonah J. Stulberg, M.D., Ph.D., M.P.H.; Reiping Huang, Ph.D.; and Lindsey Kreutzer, M.P.H. *Association between surgeon technical skills and patient outcomes*. JAMA Surgery, August 19, 2020; 155(10):960–968.

The study found that “better technical skill scores, assessed via intraoperative video, were statistically significantly associated with lower rates of any complication, unplanned reoperation, and death or serious morbidity. Overall, technical skill scores were associated with approximately 26% of the variation in risk-adjusted complication rates.” Greater demonstrated skill and past performance yields better results for patients.

Once again, right mindset. Right market.

The wrong market: The allure of historical data

Despite our experience in other domains, the past-performance approach typically fails when making investment choices. How a fund or a product once behaved is not a guarantee of how it will behave in the future. Yet, past performance remains a significant data point in investment decision-making due to its sheer availability. Past-performance records are a matter of course in prospectuses, advisory agreements, statements of clients' accounts, and industry data published on the web. Short-term returns change more frequently, and fluctuate by larger amounts, thus attracting investors' attention all the more. Often the only offsetting, legally mandated risk disclosure in a communication is that "past performance does not guarantee future results." Measured in terms of pure volume and availability of information, the past performance warning pales in comparison with information generated on historical returns.

Simply put, it's the wrong market. Investment outcomes are subject to randomness, cyclicity, the influence and time-period dependency of initial conditions, and the impact of many more independent variables. Consequently, insights gained by investment analysis and evaluations based on past performance

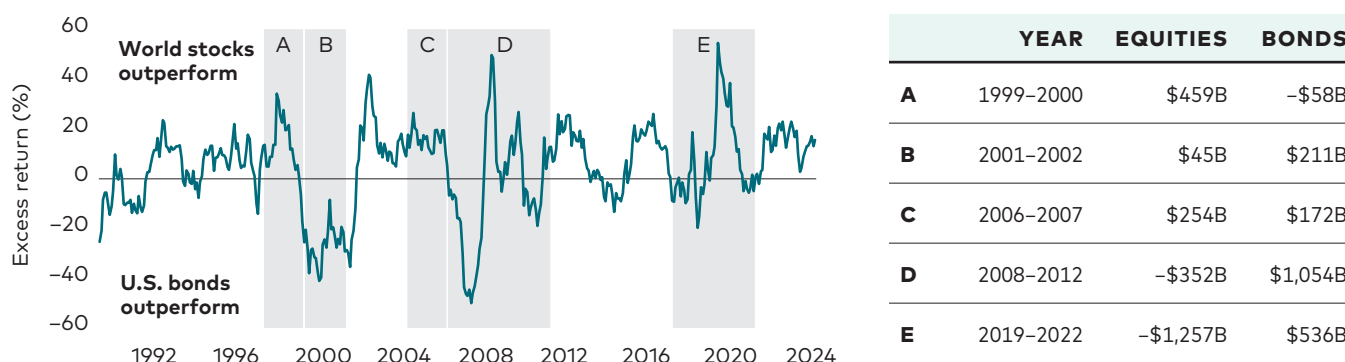
fail to produce the desired outcomes when applied to investing.

The tendency of many investors to rely on past performance as a factor in their decision-making is further complicated by the question of manager skill. Some investors would argue that historical outperformance could indicate a manager's skill—and this may be true. At the same time, most money managers are likely to be highly skilled in one way or another (such as in their cognitive ability, breadth of investment experience, or knowledge of markets and instruments); but rarely are they highly skilled in all of these ways all the time. The link between superior past performance in any given period and skill may be as much a coincidence as it is evidence of a strong scientific link between the two.

Why does this matter? Many individual and institutional investors inadvertently become momentum investors, investing new cash flows when prices are rising, and selling when prices are falling. Historical studies of mutual fund cash flows show that, after protracted periods of relative outperformance in one area of the market, sizable cash flows tend to follow (**Figure 6**).

FIGURE 6.

Cash flows in market segments wax and wane over time, dependent on trailing performance



Sources: Vanguard Investment Advisory Research Center, based on data from MSCI, Bloomberg, and Morningstar, Inc.

Data is as of December 31 for each year cited. Excess return is the difference between the return of broadly diversified world stocks and that of U.S. bonds. World stocks represented by MSCI All Country World Index; U.S. bonds represented by Bloomberg U.S. Aggregate Bond Index

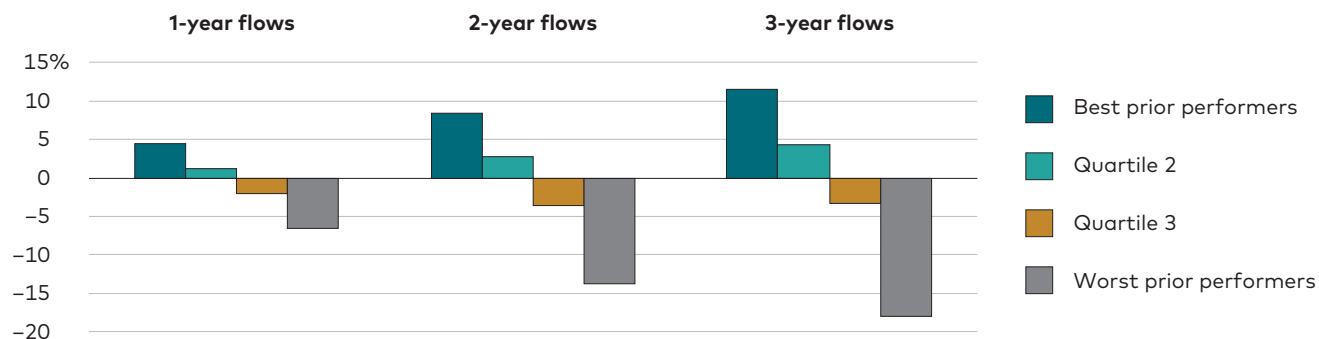
Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

This is true both at the macro level shown on the previous page (**Figure 6**), as investors time performance between stocks and bonds, as well as the fund level, shown below (**Figure 7**). Our research shows that greater than 100% of cashflow, over one-, two-,

and three-year periods flows into active equity funds in the top quartile of performance relative to their peers over the prior three years (**Figure 7**). Think of this as the proverbial Michelin star of investing. It makes intuitive sense. **It's the right mindset.**

FIGURE 7.

Cash flows closely follow relative performance



Sources: Vanguard Investment Advisory Research Center, based on data from Morningstar, Inc.

Notes: Flows are for all U.S.-domiciled active equity mutual funds and cash flow is a percentage of the beginning-of-period base assets. The evaluation period ran from January 2020 through December 2022, with depicted chart analysis from January 2023 through December 2025.

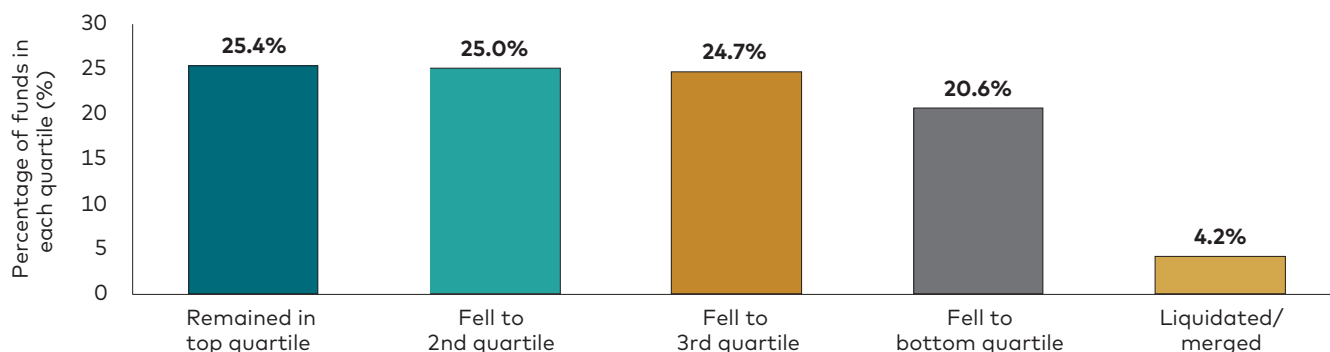
Past performance is no guarantee of future returns.

However, has this approach led to consistent investment success? Consider the active equity mutual funds ranked in the top quartile of performance as of December 31, 2022, and their subsequent three-year performance through December 31, 2025 (**Figure 8**). At the end of the period, only 25.4% of the funds remained in the top quartile. A roughly equal number

of funds fell to the bottom quartile and almost twice as many fell to the second and third. Performance persistence has essentially been a random proposition. This is the proverbial Yelp review of investing, except it's the wrong market; past performance was *not* indicative of future results.

FIGURE 8.

Subsequent three-year performance (through 2025) of funds originally ranked in top quartile for three years ended 2022



Sources: Vanguard Investment Advisory Research Center, based on data from Morningstar, Inc.

Notes: The evaluation period of U.S.-domiciled active equity mutual funds ran from January 2020 through December 2022, with depicted chart analysis from January 2023 through December 2025. Figures may not total 100% because of rounding.

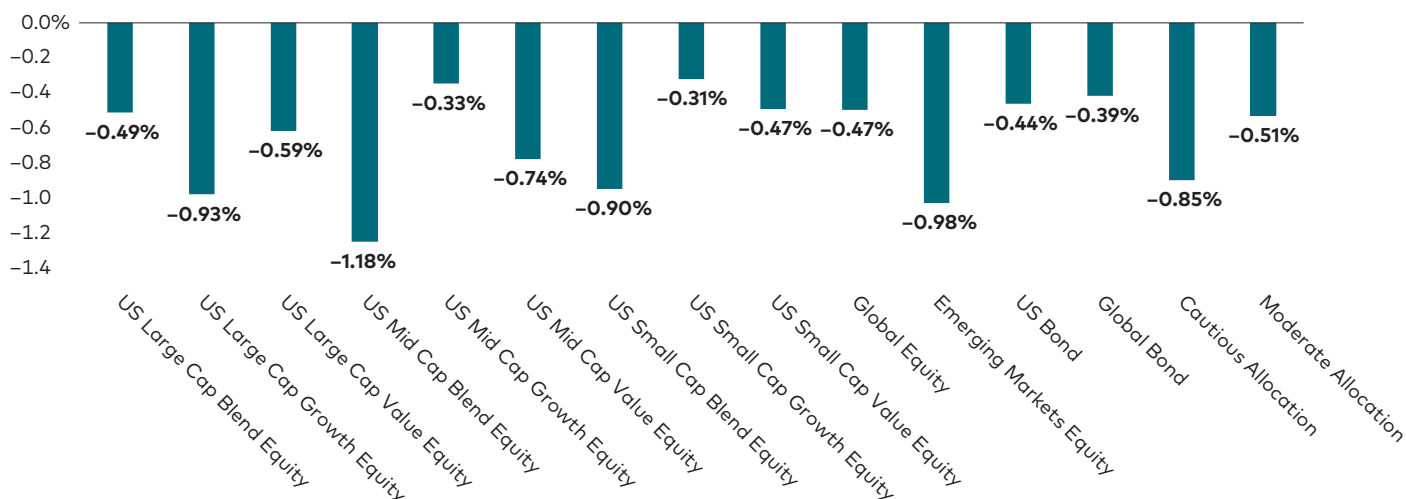
Past performance is no guarantee of future returns.

Whether investors are relying on past performance data alone, or criteria related to that data, the result is the same. New investor cash flows track recent performance and, as a result, investor returns and the actual experience of fund investors tend to lag the

total returns of the vehicles in which they invest (**Figure 9**). Some may say that this is irrational behavior, but we believe that the irrational behavior would be to *not* apply this decision-making process to investing given how well it works in other areas of life.

FIGURE 9.

Investors in aggregate, tend to trail the funds in which they invest



Sources: Vanguard Investment Advisory Research Center, based on data from Morningstar, Inc.

Notes: All sub-asset classes (including Cautious Allocation and Moderate Allocation) are Morningstar Category classifications, as defined by Morningstar, Inc. Analysis covers the 10-year period from 2016 through 2025.

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Principles of behavioral coaching

Given the seemingly sound logic in our investment decision-making process that fails to produce the desired outcomes, how can we best manage the uncertainty that accompanies investing decisions?

We think the path to improving investor decision-making starts with educating ourselves and our clients on why the process of investment selection based on recent past performance differs materially from the other life decisions, both large and small.

Once we acknowledge that we too, despite years of advising clients, building portfolios, and managing market expectations, fall into these common decision traps, we can then enable our clients to achieve better outcomes. In 2018, Vanguard first published the *Advisor's Alpha Guide to Proactive Behavioral Coaching*, in which we outlined the process by which advisors can do just that. By focusing on three simple principles—planning, proactivity, and positivity—advisors can coach their clients to success.

Planning: *The best foundation*

Focus on long-term outlooks and goals and “the percents clients care about,” aka progress toward goals as opposed to markets. This can best be done through the creation of a written financial plan.

- A written financial plan is the foundation of behavioral coaching.
- A “simple” financial plan is better than no plan at all.
- Learn the “why”—the client’s emotional reward for achieving their goals.

A written financial plan is an invaluable tool, not only for asset management, but also for relationship management. We consider a written financial plan to be the best foundation for behavioral coaching, as it provides a base for all of the crucial inputs needed to help an investor reach their goals: their objectives, both near-term and longer-term, as well as their constraints, such as their sensitivity to price fluctuations and taxes. Ultimately, most investors only care about market returns in so much as they impact investors’ ability to meet these goals. A continual emphasis on the financial plan can help remove some of the stress of following the day-to-day volatility inherent in investing, thus setting a strong foundation for future coaching in the moments that matter.

Positivity: *Words matter*

Regardless of how powerful our examples of misunderstanding the market might be, given the sensitive nature of embracing a new, potentially uncomfortable approach to decision-making can prove difficult for clients. This is to be expected. The way in which we manage client engagements and conversations regarding this new approach should be anchored in language that conveys our empathy and understanding.

Communicating with positive language and empathy is a concept that is written about extensively and has a demonstrable impact on client outcomes. Our ability to view the world from our clients’ perspectives and relate our guidance to them in relation to that perspective conveys that we have a deep sense of who our clients are as people, beyond their investments.

Positivity does not mean that everything is always going to be fine, it simply means that your clients are prepared for when things are not fine. We frequently hear phrases like “investors are their own worst enemies,” but as we previously addressed, they are not the problem—the problem is the market.

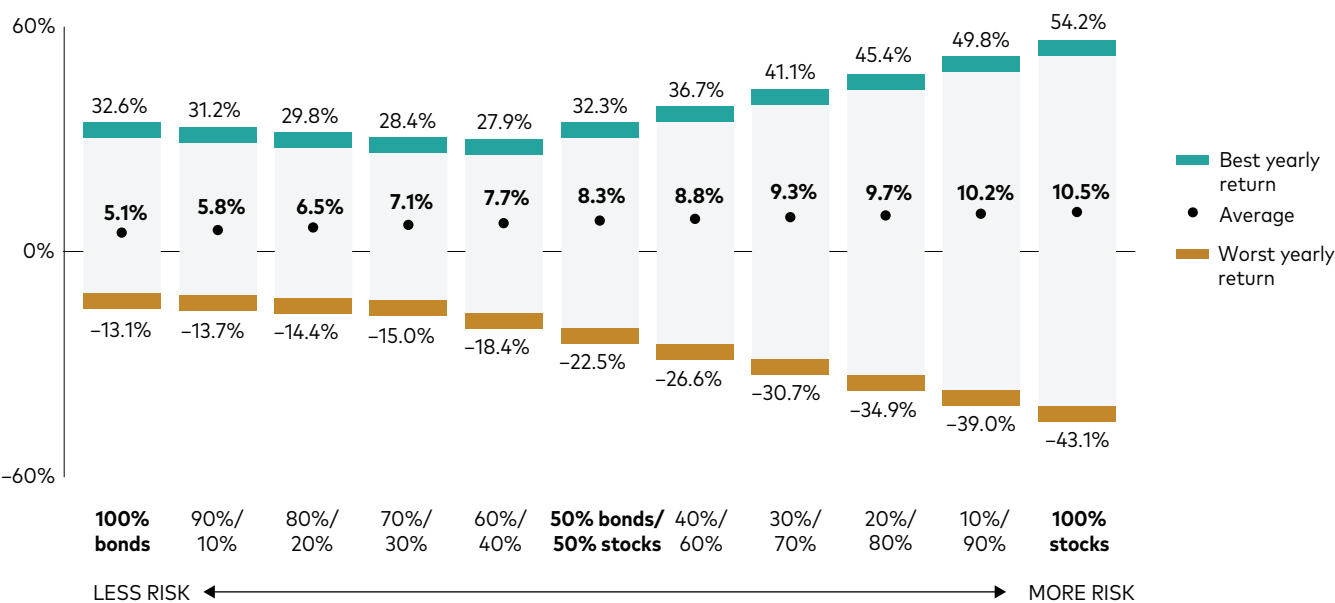
Proactivity: Coach for tomorrow today

Behavioral coaching in the moment is most effective when the client has been prepared for it in advance. Some proactive efforts are obvious, for example, initiating calls to clients who might react to market headlines. Some efforts are less obvious, such as leveraging a financial plan to anchor clients to their goals rather than the markets.

The key is to set reasonable expectations and to remind clients that risk is not an abstract, unlikely event, but rather, given a long enough time horizon, it is

a near certainty that significant drawdowns will occur **(Figure 10)**. Additionally, advisors can proactively help their clients understand that their risk tolerance during calm times may not reflect how they are going to feel when those drawdowns actually occur. For example, the thought of losing 20% or more of their assets might feel more acceptable conceptually rather than the reality of living through the events that could cause such a drawdown.

FIGURE 10.
Expected long-term returns increase with higher equity allocation, but investors bear greater risk



Sources: Vanguard Investment Advisory Research Center calculations through December 31, 2025, using data from FactSet.

Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

Stocks are represented by the Standard & Poor's 90 Index from 1926 through March 3, 1957; the S&P 500 Index from March 4, 1957, through 1974; the Wilshire 5000 Index from 1975 through April 22, 2005; the MSCI US Broad Market Index from April 23, 2005, through June 2, 2013; and the CRSP US Total Market Index thereafter. Bonds are represented by the S&P High Grade Corporate Index from 1926 through 1968, the Citigroup High Grade Index from 1969 through 1972, the Lehman Brothers U.S. Long Credit AA Index from 1973 through 1975, the Bloomberg U.S. Aggregate Bond Index from 1976 through 2009, and the Bloomberg U.S. Aggregate Float Adjusted Bond Index thereafter.

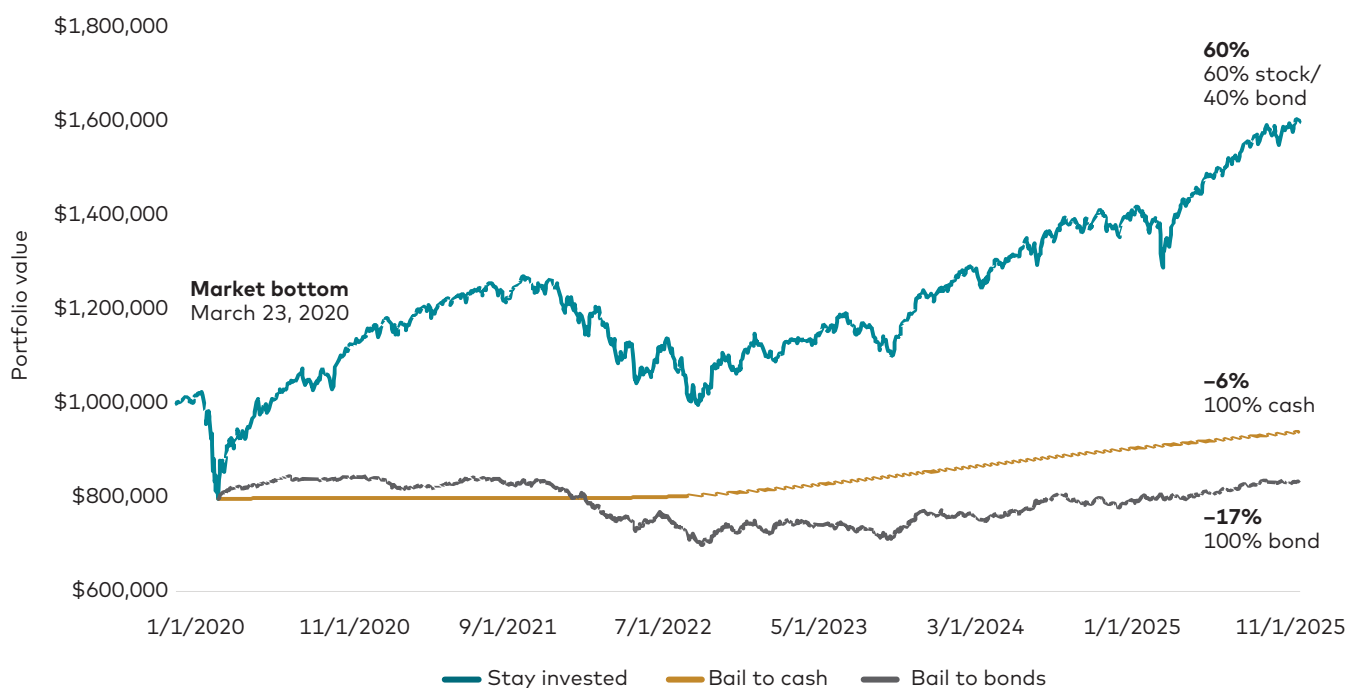
Win-win = Good for your clients; good for your business

Vanguard research (Kinniry et al., 2022) has consistently shown that behavioral coaching is one of the most significant services you can provide for your clients to better help them to reach their long-term goals. In fact, one single episodic coaching opportunity could more than justify a lifetime of client advisor fees (**Figure 11**). For example, imagine you had a client who

wanted to bail out of the market at the bottom of the COVID-19 crisis, but you were able to coach them to stay the course. That value may have ostensibly been added in a 15-minute phone call, but that conversation would have built upon many years of planning, proactive coaching, and positive communication.

FIGURE 11.

The COVID-19 crisis tells the stay-the-course tale



Hypothetical example. Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

Sources: Vanguard Investment Advisory Research Center calculations through December 31, 2025, using data from FactSet.

The equity portion of the 50% stock/50% bond portfolio consists of 60% CRSP US Total Market Index and 40% FTSE Global All Cap ex US Index. The bond portion consists of 70% Bloomberg U.S. Aggregate Float Adjusted Bond Index and 30% Bloomberg Global Aggregate ex-USD Float Adjusted RIC Capped Hedged Index. Cash is represented by the FTSE 3 Month US Treasury Bill Index. The 100% bonds portfolio consists of 70% Bloomberg U.S. Aggregate Float Adjusted Bond Index and 30% Bloomberg Global Aggregate ex-USD Float Adjusted RIC Capped Hedged Index. "Stay invested" refers to keeping all assets in the 50/50 stock/bond portfolio and rebalancing monthly.

Vanguard has also demonstrated (Kinniry et al., 2022) that driving superior outcomes through relationship-oriented services, such as behavioral coaching, is likely the biggest driver of trust between you and your clients. This is the primary driver of practice outcomes, including client acquisition via referrals, client retention, and asset consolidation with their primary advisor.

Change the market or change the mindset. Markets are beyond our control, but mindsets are something we can influence. Reframing investors' mindsets to match the market we are operating in, by embracing sound principles of behavioral coaching, is the key to both client and practice success.

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