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Seven Steps to Goals-Based Financial Planning

Goals-based investing has been a hot topic in the industry for years, with firms adopting new strategies to differentiate themselves and meet demand. Top wirehouses have gone so far as to revamp their platforms to track performance relative to client goals. And assets in so-called “outcome” or goals-based solutions have nearly doubled since 2012.

What was once a passing trend has quickly become the status quo.

It’s proof that today’s investors are concerned with more than just beating market returns. They want a new approach—one that takes more than investments and retirement into account, but rather considers and prioritizes all of their major financial goals.

The focus has clearly shifted toward providing more personalized, holistic financial plans. But are they effective?

An optimal, goals-based strategy can add more than 15% in utility-adjusted wealth.*

+15%

The latest in a long line of Morningstar research is proving that these plans might be. New work from David Blanchett, head of retirement research for Morningstar Investment Management, argues that an optimal, goals-based strategy can add more than 15% in utility-adjusted wealth.*

Shifting the focus from retirement to a broader, all-encompassing approach puts the investor—rather than the investment—first.

With this guide, you’ll learn seven tangible steps on how to become more client focused.

1. Change the Focus

A goals-based financial planning process can pay off in the long run compared to more traditional strategies. But clients might still be in a short-term performance mentality. To combat this, emphasize goal completion rather than performance in client communications.

Quick Tip
Take pure performance numbers off the first page of a report, and replace them with an overall wellness profile that communicates an individual's progress toward achieving certain milestones.

2. Take a Total Wealth Approach

Clients are worth more than the assets on their balance sheets. Their financial well-being depends not only on their investments, but on job type, age, location, family situation, and other personal circumstances. Understanding the total resources available to clients, as well as potential limitations, provides a clearer perspective on what it's going to take to accomplish their goals.

Quick Tip
Have clients take the extra step of filling out a worksheet that shows all of their accounts, assets, and liabilities, as well as the type of work they do — not just the dollars they're looking to invest.

3. Think Outside the Portfolio

While investments alone can accomplish certain goals, being knowledgeable and open to non-portfolio solutions, such as annuities, can give clients a wider range of potential options. Don't generalize a product or approach and dismiss it without understanding the respective pros and cons.

Quick Tip

Annuities are a form of insurance, so think of them as risk-management tools—not investments—and frame your client discussions accordingly.

4. Emphasize Best Behavior

Most planners have hilarious (and often terrifying!) examples of clients behaving irrationally with their money. Understanding why clients make irrational choices can help advisors learn how to position clients to achieve their goals. Recent behavioral research suggests that goals can be best met through setting achievable short-run goals that produce the long-run goal over time.

Think of yourself not just as a steward of your clients' capital, but as a champion of their interests and well-being.

Quick Tip

An Investment Policy Statement forces you to put your investment strategy in writing and commit to a disciplined, long-term plan. It's both a blueprint and a report card. Regularly review it with your clients to help keep them from overreacting to a market correction or jump.

5. Correctly Define Risk

When thinking about risk, it is common to focus on risk preference, asking clients how they feel about taking risk (which is commonly proxied through risk tolerance questionnaires). But the conversation can't just be about "tolerance." The other important component of risk is risk aversion — the amount of risk individuals *should* take given available resources, not just the risk they want to take.

Financial professionals play a key role in this process. Rather than relying on an individual's "gut," which is influenced by any number of factors, take an active role in diagnosing the total risk profile and communicate the pros and cons of the preferred risk strategy with the reality at hand.

Quick Tip
Most people are risk-seeking when markets have done well and risk-averse after they have done poorly. Spend time with your clients to reflect back on both the good and bad times to correctly gauge their risk preference.

6. Build Smarter Portfolios

While it may be operationally simpler to have a single allocation for each equity risk level, in reality different goals have different risks that should be incorporated into the portfolio optimization routine. For example, while a younger individual might be interested in maximizing return per unit of risk, an older individual might be more focused on maximizing return per unit of risk after considering inflation (i.e., on a real basis). These two approaches can lead to materially different portfolio allocations.

Quick Tip

Goals-based portfolios commonly have a “glide path” that details how they should change over time. Remember, a portfolio is going to be different for savings set aside to fund a goal that may occur in a few years versus something like retirement, which may be in the far future.

7. Adopt New Technology Solutions

Embracing a goals-based approach requires new strategies, but just as important are new technologies to help simplify your workflow. The growth of goals-based planning is already leading to several new solutions that help advisors better serve their clients. Key features to look for focus on optimally funding goals, building efficient portfolios, monitoring progress, and communicating the value of your approach to clients.

Quick Tip

As part of your diligence, remember that many providers offer free trials, seminars, and demos of their offerings. Discuss your experiences with your peers to understand not only what will work today, but how well the technologies will scale as your business grows.

Most individuals aren't financial experts. They don't speak in terms of alpha and beta, or even keep up with their accounts on a daily basis. But when the time comes for them to accomplish one of their financial goals—whether it's funding a child's wedding or settling into retirement—they need to know the money will be there.

That's why the profession of financial planning must be built around helping people accomplish their goals. It's not only an opportunity for you to provide better advice to individuals; it's a way for you to speak their language and make closer, long-lasting connections with your clients.

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*This result was found based on one hypothetical scenario in which a number of assumptions were made. It is presented to provide an indication of a goal-based strategy's potential results but should in no way be considered indicative or a guarantee of an actual client's experience using the same strategy. To view the methodology used in this scenario, please view the full study at http://www.onefpa.org/journal/Pages/JUN15-The-Value-of-Goals-Based-Financial-Planning.aspx.