

# *Changing the Conversation by Investing for Goals*

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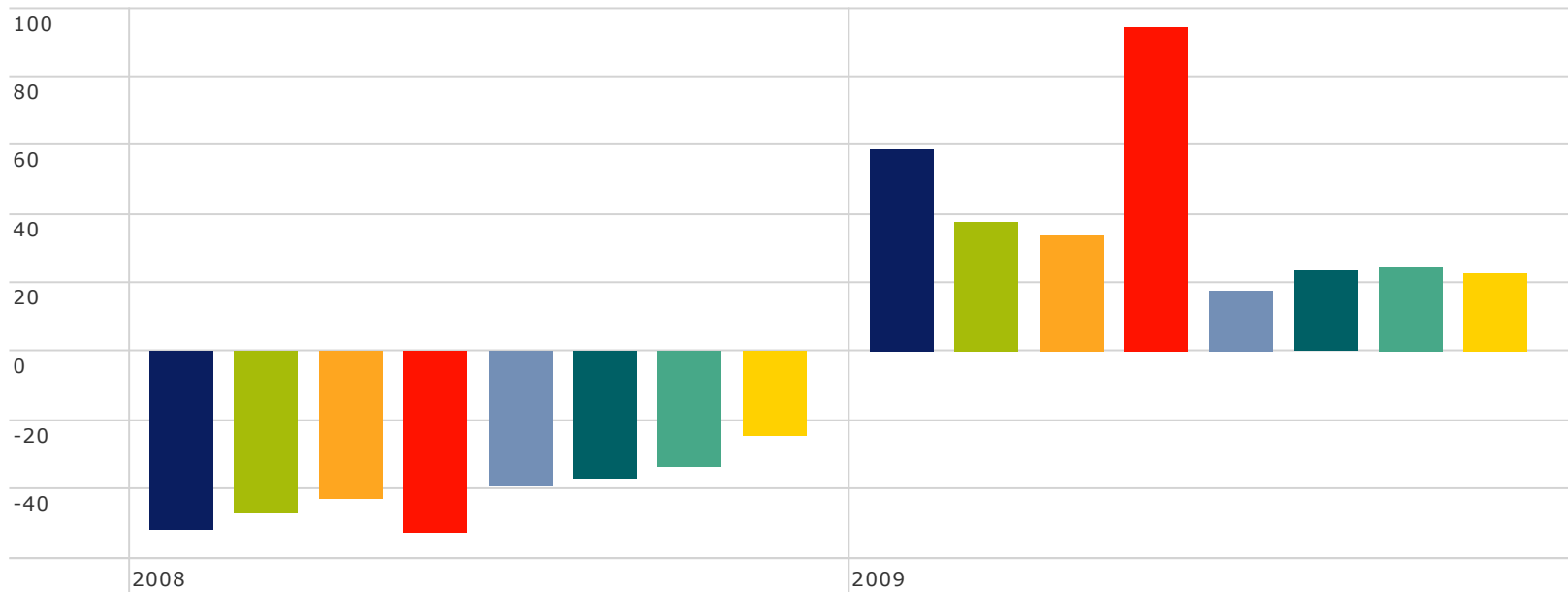
*Making investment decisions based on goals  
provides a framework for you and your advisor to  
focus on what is most important*

*(and it's not the ups and downs of the S&P 500)*

# WHAT DOES “WEALTH MANAGEMENT” MEAN?

A well-designed Wealth Management Model should provide you with

- a consultative discovery process that places an emphasis on your goals, the short-term as well as the long-term goals
- customized solutions over a broad spectrum of financial needs – and, because there is often more than one way to address a need, you want choices. Solutions should fit your specific needs and goals
- on-going consultations with you and your other professional advisors about the customized solutions designed to help you meet your goals



Investment Name		
■ MSCI AC Far East Ex Japan USD	■ MSCI AC World Ex USA USD	■ MSCI EAFE GR USD
■ MSCI EM Latin America USD	■ DJ US Select REIT TR USD	■ S&P 500 TR
■ Russell 2000 TR USD	■ DJ Moderate Portfolio TR USD	

Source: Morningstar Advisor Workstation

Many conversations took place in the first quarter of this year that offered some variation of, “Well, at least your portfolio did better than the fill-in-the-blank index”.

## Two different ways to approach the decision-making process

### Traditional/ Institutional Assumptions

- ❖ Investor objectives are roughly the same, given age and risk tolerance
- ❖ The trade-offs are expected return versus standard deviation
- ❖ Tolerance for risk can be measured with a series of questions and a “score”
- ❖ Investors behave rationally



### Focused on Goals

- ❖ Investors have different goals with different objectives
- ❖ Trade-offs should be based on goal achievement
- ❖ Investors have different attitudes and responses about risk for each goal
- ❖ Investors make emotional decisions based on behavioral biases

## What Is “BEHAVIORAL BIAS” And What Does It Mean For An Investor?

- An investor may seek to avoid actions that could make her feel uncomfortable about her past decisions - even if taking those actions she’s avoiding might be in her best interest. Investors commonly hold onto losing investments longer than they keep winning ones due to **REGRET AVOIDANCE**
- Overestimating her ability to predict market events can lead to emotional trading, as she tries to work the market to her advantage. An investor will often wind up with high transaction costs and uneven investment performance because of **OVER- CONFIDENCE**
- Some investors have a tendency to be overly influenced by random occurrences and consequently read into a series of coincidences a pattern that is unlikely to persist. **OVER-REACTION** is often part of a cycle of buying high and selling low
- She may believe she predicted an event when she did not. This could reinforce overconfidence and can lead to **HINDSIGHT BIAS**
- She may continue to hold a belief even when contradictory information comes to light. An investor will stay with an inappropriate investment strategy despite strong signs that it’s not working due to **BELIEF PERSEVERANCE**

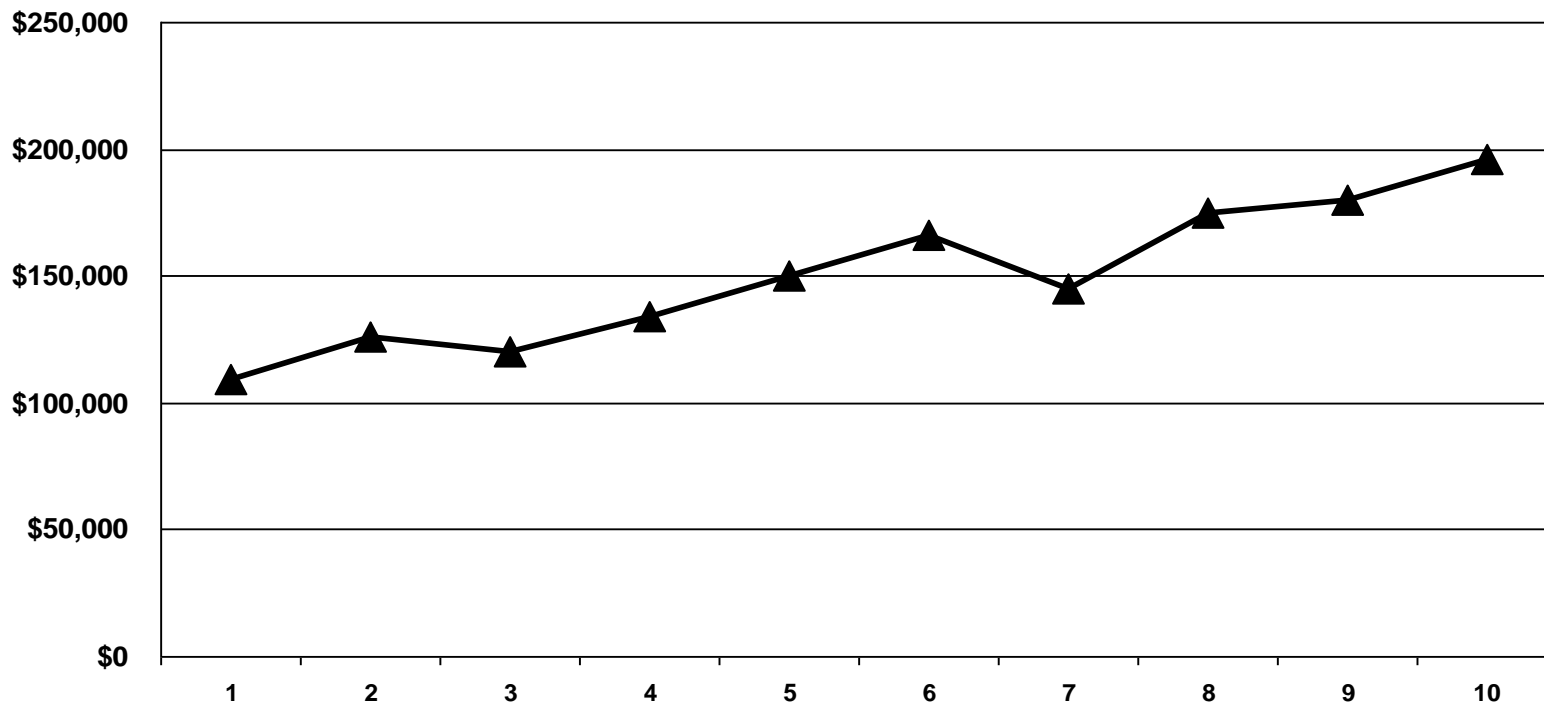
## WHAT MIGHT AFFECT AN INVESTOR'S ABILITY TO REACH HER GOAL?

Ellen's investor profile and her portfolio reflect her conservative nature. Her portfolio is designed to generate income to help her meet her cash flow needs while allowing for some capital growth to help her keep up with inflation. She had filled out a questionnaire a few years ago when she transferred her account and she enjoys a good relationship with her long-time financial advisor.

Goal:	Pay for granddaughter Amy's college degree
Four Year Program Today:	\$140,000 (\$35,000 per year)
College Costs in 2019:	\$196,000 (\$49,000 per year with inflation)
Amount Saved to Date:	\$109,000

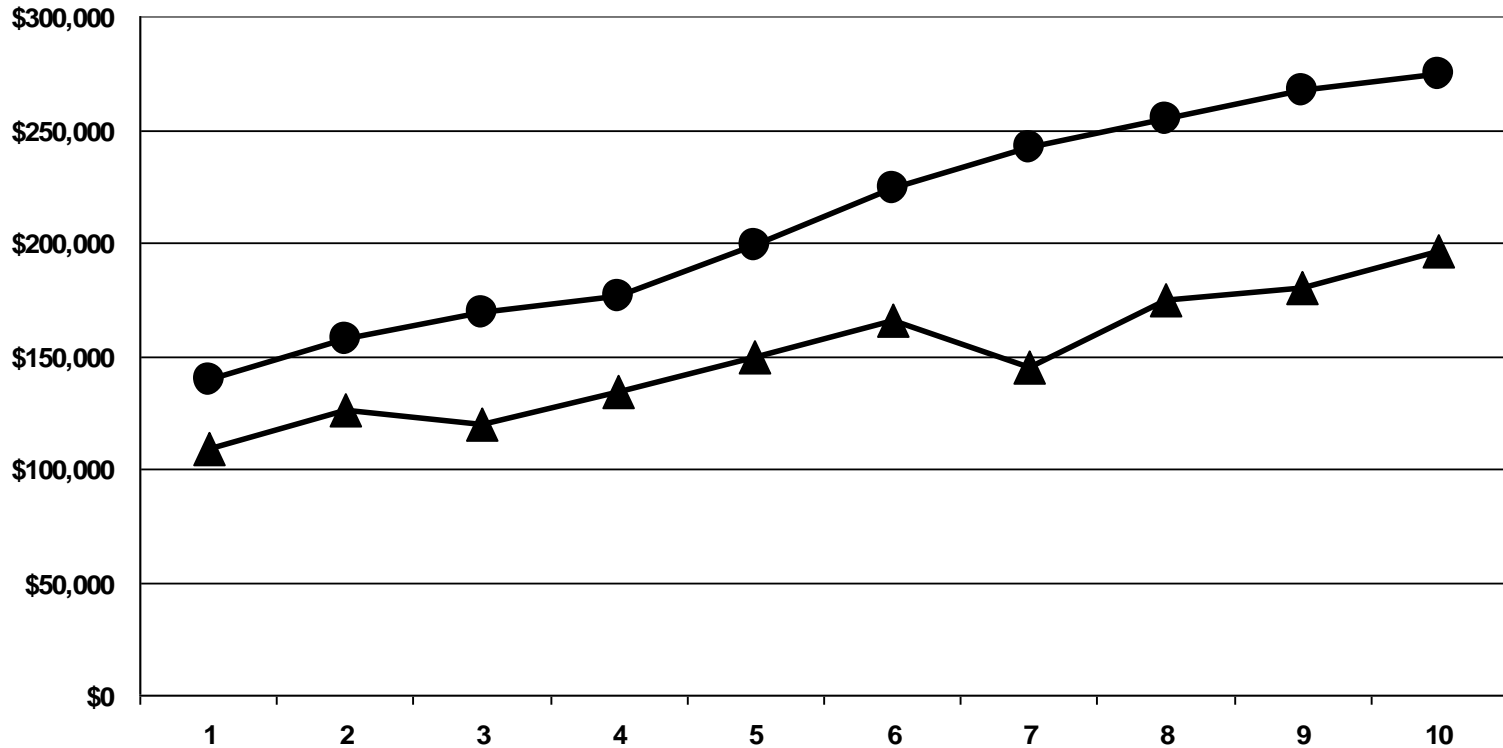
Ellen's portfolio returns were better than her portfolio's benchmark of 5% by 1% each year over ten years, and at an average rate of 6% per year, she achieved her goal of \$196,000. Did she achieve her goal of paying for Amy's college degree in full?

## Aligning a Strategy with a Goal



Ellen achieved her goal of growing her account\* from \$109,000 to \$196,000 (\*and because she held all of her investments in a single account, this occurred in her “mental account” – the one we all keep when we look at a big picture but have a sense of or can visualize its parts).

## Aligning a Strategy with a Goal



The disconnect (the \$79,000 gap between what she'd accumulated and the actual cost of a four year degree) occurred because of a critical assumption: college costs rise at the rate of inflation commonly used in investment projections, the CPI. College costs may actually rise at a much faster rate and, in this example, they increased by 7% a year rather than an average of 3.5%.

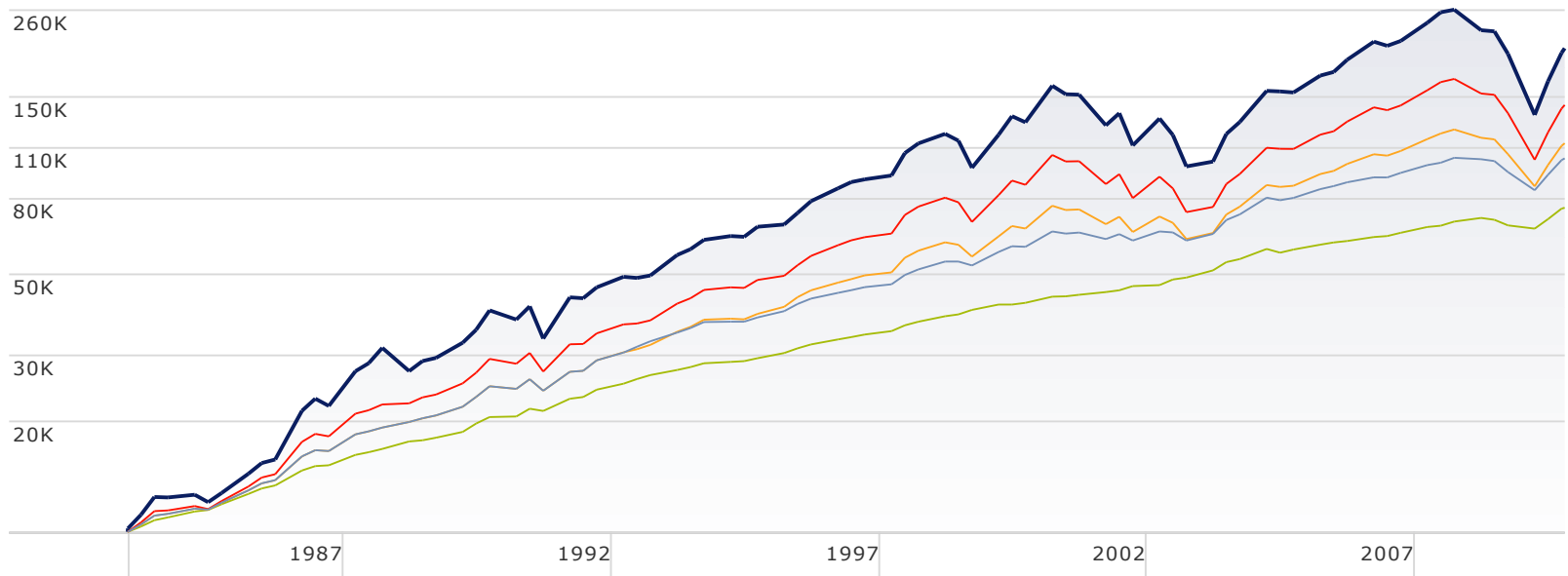
## What can happen when a goal and an investment strategy are not properly aligned?

Ellen was still able to help Amy with her college costs, though not as much as she had hoped to some ten years earlier. What might have made for a potentially more satisfying outcome for her? Some suggestions include:

- **FIRST AND FOREMOST:** a thorough analysis of Ellen's capacity to meet all of her own lifetime income needs – and then some – through her financial resources
- An in-depth conversation with her advisor about her goal to fund Amy's college degree, which would have raised questions about a number of assumptions, including those regarding inflation factors (college versus the CPI, for example)
- A separate account for this goal and, with a ten year time horizon, a less conservative approach initially
- Progress towards this goal evaluated at least annually; it was a ten year goal at the outset, but over time, it became a six year, then a three year, then a two year goal. Her investment strategy should reflect a combination of the market environment and her distance from her goal. Three to five years out, she and her advisor might have begun to shift the allocation to something less aggressive than initially selected; one to two years away, even more so
- And, if her dollar goal had been achieved ahead of schedule, she might have opted for a more conservative strategy (with more cash equivalents and fixed income) even earlier, giving her a greater level of confidence in her ability to fulfill her goal

## Two Ways To Look At Risks and Goals

	Risks and Goals from a Traditional or Institutional Viewpoint	Risks and Goals from a Client's Viewpoint
Objective	<ul style="list-style-type: none"> <li>• Align portfolio returns against market or custom benchmarks</li> </ul>	<ul style="list-style-type: none"> <li>• Protect against loss</li> <li>• Generate income</li> <li>• Growth</li> </ul>
Risk Measure	<ul style="list-style-type: none"> <li>• Standard deviation and beta</li> <li>• R-squared</li> <li>• Risk relative to benchmark</li> </ul>	<ul style="list-style-type: none"> <li>• Risk of not meeting goal</li> <li>• Risk of loss</li> </ul>
Return Measure	<ul style="list-style-type: none"> <li>• Annualized return</li> <li>• Cumulative return</li> <li>• Alpha</li> </ul>	<ul style="list-style-type: none"> <li>• Dependability of cash flow</li> <li>• Reaching target value for goal</li> <li>• Absolute versus relative return</li> </ul>
Reference Point	<ul style="list-style-type: none"> <li>• Return compared to (or “relative to”) benchmark</li> </ul>	<ul style="list-style-type: none"> <li>• Attainment of goals</li> <li>• “High water mark”</li> </ul>

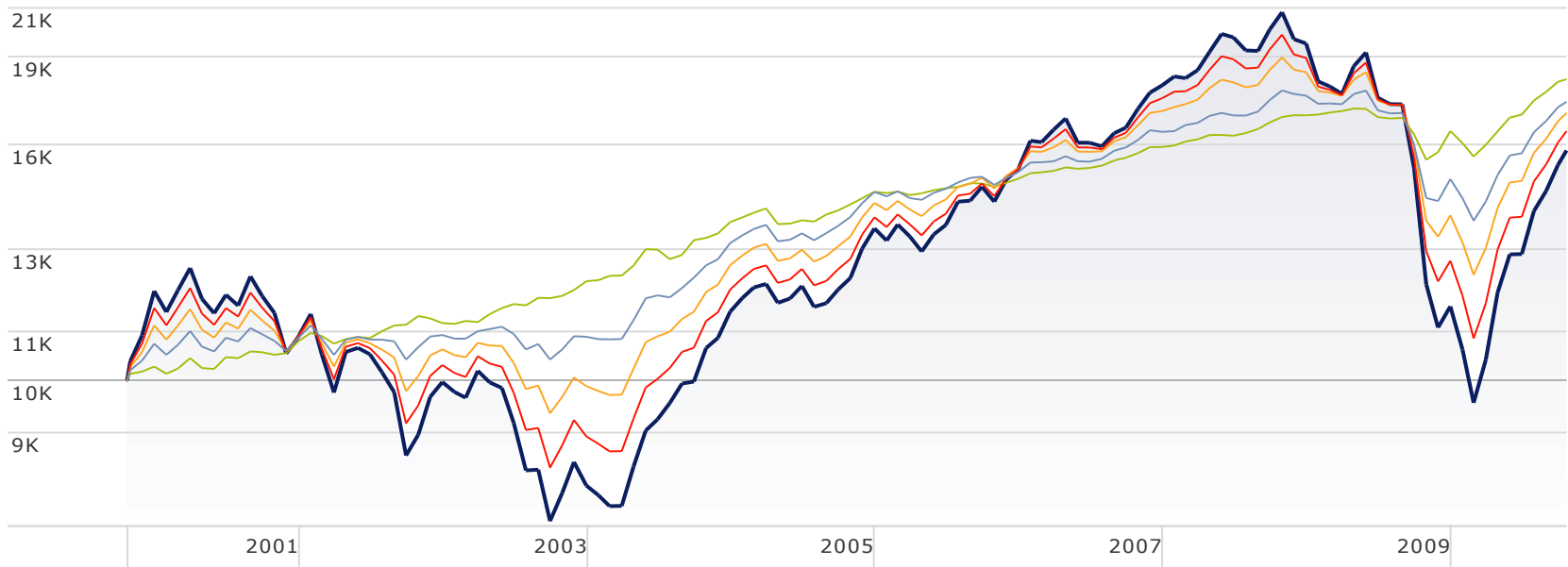


Investment Name	Value
DJ Aggressive Portfolio TR US..	49.05K
DJ Conservative Portfolio TR ...	25.18K
DJ Moderate Portfolio TR USD...	30.63K
DJ Moderately Aggrsv Portfoli..	36.46K
DJ Moderately Conservative P...	30.58K

Source: Morningstar Advisor Workstation

1983 to October 2009

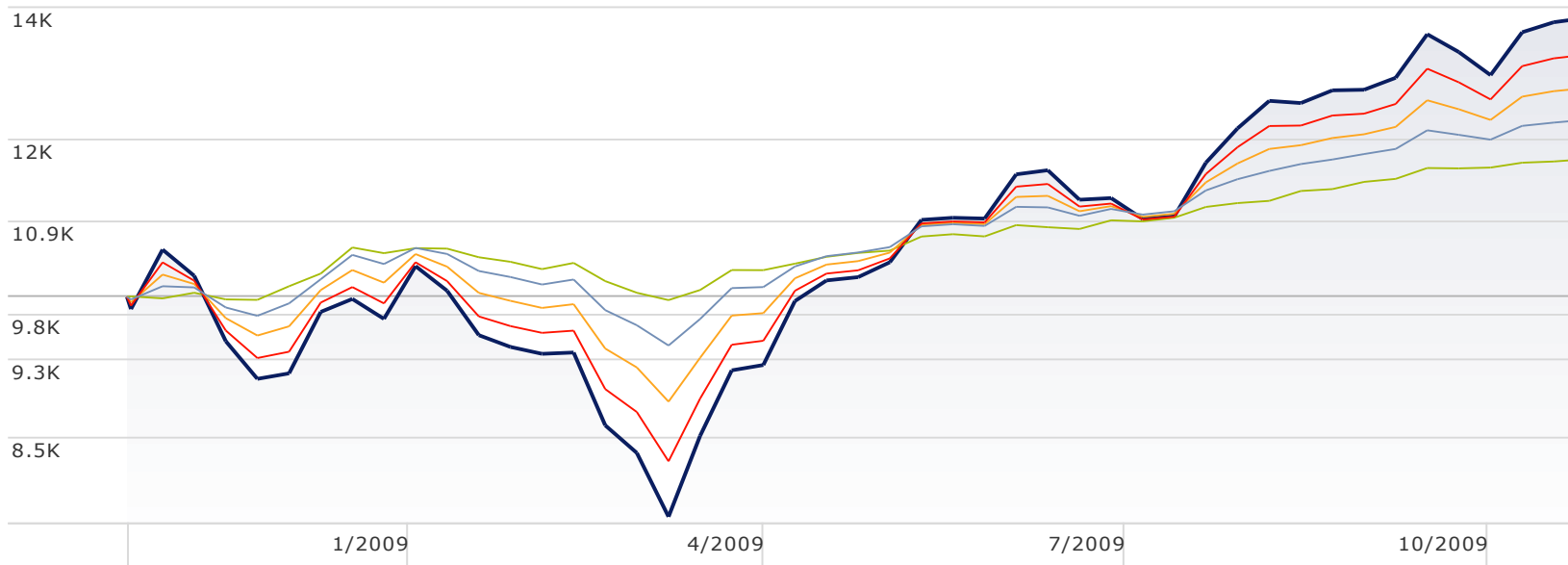
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Investment Name	Value
DJ Aggressive Portfolio TR US..	9.56K
DJ Conservative Portfolio TR ...	12.72K
DJ Moderate Portfolio TR USD..	11.02K
DJ Moderately Aggrsv Portfoli...	10.25K
DJ Moderately Conservative P..	11.8K

2000 to October 2009: A ten-year goal funded in July of 2002 was no longer a ten-year goal by May of 2007

Source: Morningstar Advisor Workstation



Investment Name	Value
DJ Aggressive Portfolio TR US..8.35K	8.35K
DJ Conservative Portfolio TR ...10.05K	10.05K
DJ Moderate Portfolio TR USD..9.21K	9.21K
DJ Moderately Aggrsv Portfoli...8.75K	8.75K
DJ Moderately Conservative P...9.68K	9.68K

YTD (October 2009): The more compressed the timeframe, the greater the impact of volatility – positive or negative

Source: Morningstar Advisor Workstation

# Establish a time horizon and priority for goals

**PRIORITY**

Want To

Have To

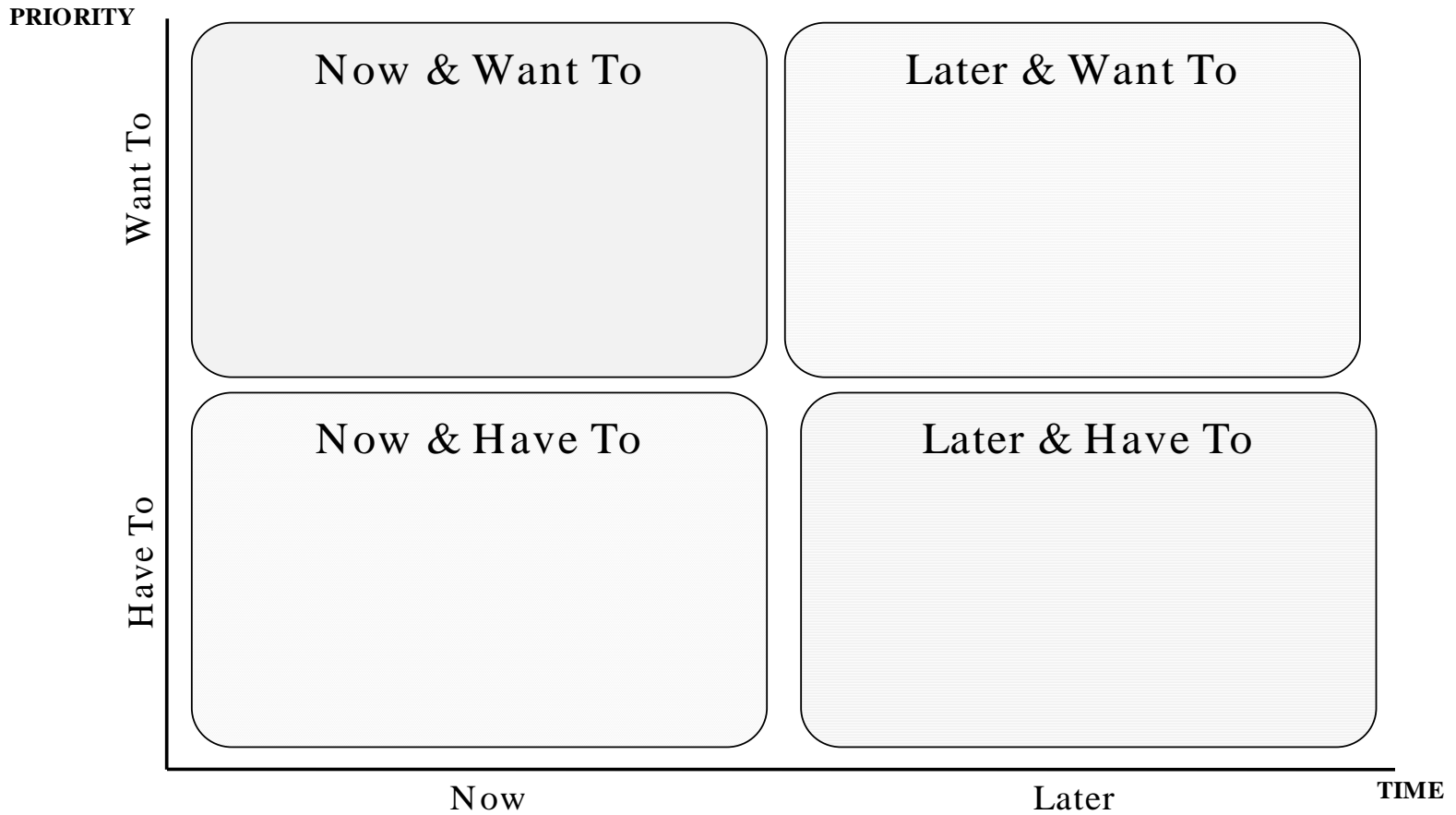


Now

Later

**TIME**

Establish a time horizon and priority for goals



Establish a time horizon and priority for goals

**PRIORITY**

**Want To**

**Now & Want To**

- Traveling 2-3 times per year
  - Remodeling the kitchen
- Help out the grandchildren's camps and piano lessons
- Increase philanthropic giving

**Later & Want To**

- Help grandkids with law school
- Establish a perpetual giving fund
- Purchase sporting equipment for girls' school in Guatemala

**Have To**

**Now & Have To**

- Maintain and enjoy lifestyle
- Put Cape cottage up for sale
- Add second bath on first floor
  - Repair roof

**Later & Have To**

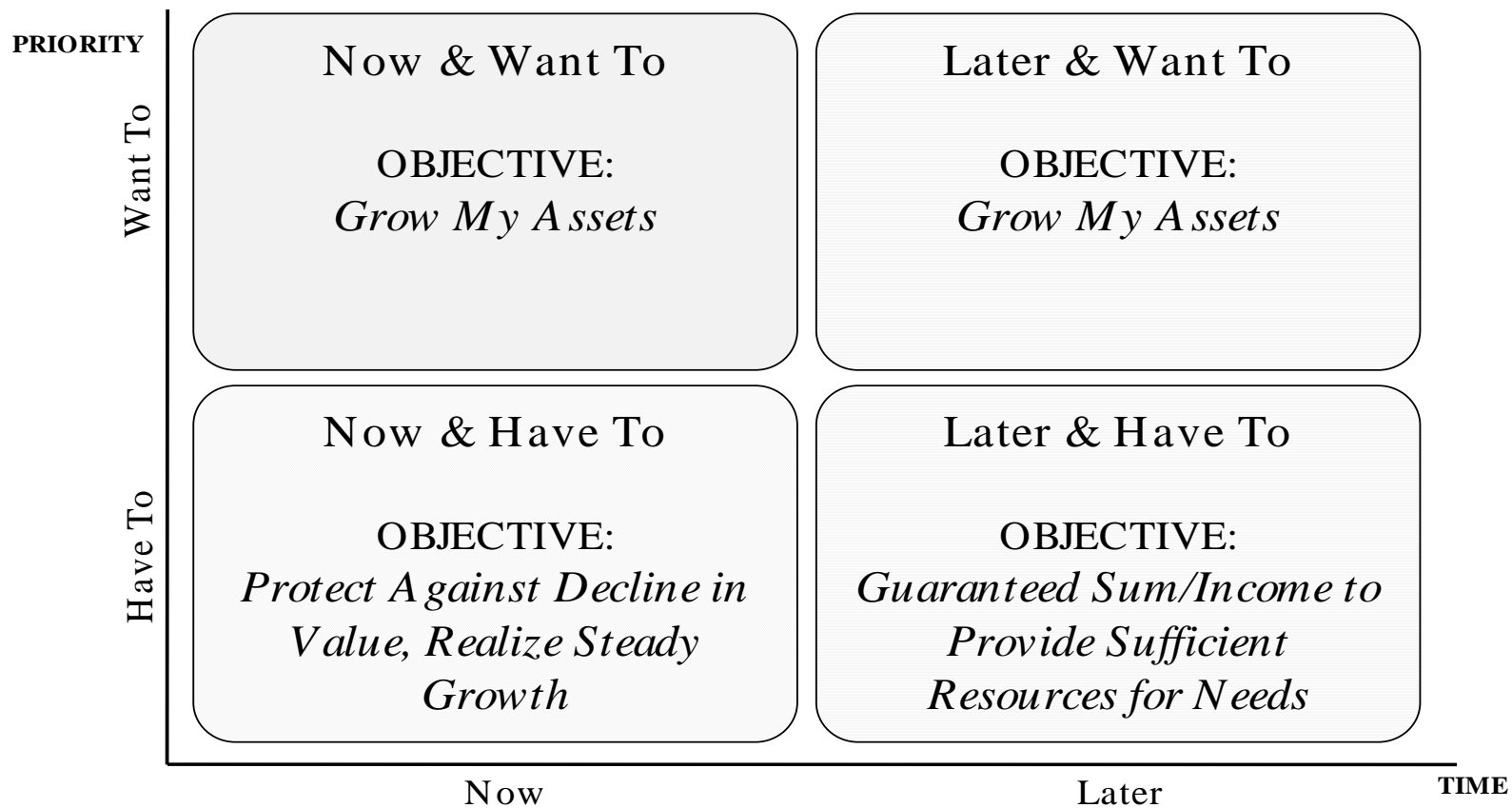
- Maintain our lifestyle
  - Contingency plan for LTC
- Resources sufficient for desired community residence
  - Landscaping near the porch
    - Repave driveway

**Now**

**Later**

**TIME**

Establish a time horizon and priority for goals



## *Creating and implementing your own Goals-Driven Process*

- Developing my goals:

What do I want to accomplish and how much will be required?
- Appraising my financial assets:

What are they and where are they?
- Performing “gap analysis”:

What do I need in order to meet those goals?
- Exploring my options:

What choices do I have?
- Implementing my strategies:

Put my plan into action
- Monitoring my plan with my goals as the centerpiece:

Keep in tune with my own goals and timeframes and keep my advisor apprised of any changes

# Making investment decisions based on goals means that

- your conversations with any of your professional advisors – including your attorney or accountant – will be more valuable and constructive for both of you
- you and your investment advisor will focus more attention on your progress towards achieving your goals and less on beating a benchmark – the interpersonal dynamics and potential benefits of your investment advisory relationship will be enhanced
- you and your investment advisor can formulate a rational framework for expectations and measurements of success
- you will be better equipped to deal with volatile markets as you remain focused on what is important about your goals and where you are on your own timeframe continuum
- you can shift the dynamic of an advisory relationship from “expert to client” to “expert to expert” through clarity about your own values and needs. You are not a number at the bottom of a risk tolerance questionnaire; you are the premier authority on what in and about your life matters to you. Arrive at your annual or quarterly advisory meetings armed with your ideas, concerns and aspirations. When you come prepared with your own agenda, you level the playing field
- you will be in a better position to evaluate whether or not a current investment advisory relationship is one suited to help you achieve your goals

## *Appendix & Disclosures*

This material is not intended to be an accurate assessment of the market environment nor as a forecast of future events or a guarantee of any future results. Nothing contained in this should be relied upon as recommendations, research or investment advice. This information is for educational purposes and represents the views of solely the presenter.