What's Current Got To Do With It?

Doing Better Than Better…

PART TWO

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In Part One of our "What's Current Got to Do With It?" series, we examined how most advisory disciplines are focused on doing better, but perhaps not the best, that can be done for clients. We evaluated how the premises of these services missed the mark when compared to Wealthcare. As we discussed, Wealthcare is based on the idea that we can do the best for our clients by:

1. Confidently achieving their goals
2. Preventing undue compromises to their lifestyle
3. Avoiding unnecessary risk

Finally, we examined how focusing on improving "current" distracts us from doing "better than better." Most advisors are used to examining "current" even though it distracts us from doing the best that can be done, takes an extraordinary amount of effort that requires the collection of each security position and asks prospects to disclose a lot of personal information on faith that something of value will result, thereby requiring more trust than often is present in early relationships.

What if we, as advisors, could more easily demonstrate our value without an excessive data gathering effort? What if our prospects could be shown our value as advisors without the faith of disclosing personal information before trust has been earned? What if we could save the collection of current information until the client was ready to implement our advice? What if we could design a plan for a client that is "just right," that confidently achieves their goals without undue compromises to their lifestyle and avoids unnecessary risk? What if we had an advisory process that made all of these things possible? First, planning would be far easier. Data gathering would be far simpler because the specifics of "current" would be saved until trust had been earned and it was time to implement a plan. Clients and prospects would be more comfortable because jargon would be minimized and discussions about goals maximized. Finally, our advice would be better because we would be focused on doing the best for a particular client. This process does exist. These goals can be achieved through Wealthcare and Goldilocks planning.

As part of an advising process, Goldilocks planning saves all the "current" data gathering for later, when it is time to implement a plan. Instead, it focuses on getting things "just right." Here is how it works: Instead of starting with detailed specifics of "current," we minimize the level of detail to only include simple total portfolio values categorized by tax treatment (taxable, tax deferred, Roth). Then we identify the client's ideal situation by accepting, rather than negotiating, those things that all clients want, such as retiring as soon as possible on a retirement income as large as possible, while saving as little as possible, and leaving an estate as large as possible while taking the least amount of risk as possible.

Each time we identify one of these "ideals," we also ask the client how much they would be willing to compromise, if needed, to meet more important goals.

Let's look at Harry and Sam, two 58 year-old clients with $1,000,000 portfolios and identical profiles. Both would ideally like to retire at age 60, but, if needed would work until 65. Ideally they would not increase their savings above the $10,000 a year they are now saving, but if necessary, they would increase their savings to $25,000 a year. Ideally they would like a retirement income budget of $100,000, but, if necessary, would be comfortable at $75,000. Ideally, they would leave a $1,000,000 estate (their current portfolio value) but, if necessary, would spend down principal. Ideally, they would have a low risk portfolio (30% equity exposure), but, if necessary, would tolerate a 60% equity exposure.

The results of these extremes are, like in the fairy tale "Goldilocks and the Three Bears," scenarios that are too hard (aggressive) or too soft (too conservative) for these clients. Our job as advisors is to find the solution that feels "just right" for Harry and Sam. But what is just right for Harry may be focused on the wrong priorities for Sam.

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Exhibit 1: Harry and Sam (two clients with identical profiles but different priorities)

CURRENT PORTFOLIO VALUE: $1,000,000 **CURRENT AGE:** 58

	AGGRESSIVE (TOO HOT)	CONSERVATIVE (TOO COLD)
RETIREMENT AGE:	60	65
RETIREMENT INCOME:	$100,000	$75,000
ANNUAL SAVINGS:	$10,000	$25,000
RISK (STOCK/BOND):	30/70	60/40
ESTATE:	$1,000,000	$0

If Harry and Sam each go to a typical advisor, one that focuses on asset allocation or shortfall (gap-additional savings) analysis, each will be starting off with a negotiation, because the advisor will not have identified what is too hard and too soft for each of them. Without understanding the upper and lower limits each client is willing to tolerate, we can see how the typical investor profile (and the advisors that use them) ignores a client's ideals and starts relationships off with a negotiation. The financial planner that depends on his financial planning tool to solve the problem by calculating the savings shortfall would discover that Harry and Sam would need to save over $1,000,000 a year to confidently achieve their ideal goals (90% confidence). The investment consultant would calculate that Harry and Sam would need 100% allocation to stocks and find investment managers that, net of expenses, would beat the market by 3.5% every year for the rest of their lives. Neither of these are practical solutions. This is why we currently begin relationships either by examining "current" or profiling with negotiation.

The typical client profile is designed to ignore a client's ideal situation (which is helpful, since our savings and allocation solutions are impractical). Instead of identifying the range between a client's ideal situation and what he finds as acceptable and discovering his priorities, the typical profile usually gets the client to negotiate each of these goals right from the start. If the profile were well designed, in theory, it would stimulate answers that would fall between these extremes. (This is true in most cases except for risk tolerance. Profiles typically tend to focus on identifying the client's maximum tolerance—so we can position them to experience it?) Instead of two extremes, or limits on hot and cold, most profiles attempt to bypass this step under the assumption that our solution is either savings or allocation. In *Exhibit 2* we have answers that are right down the middle from the "well designed" profile.

Exhibit 2: Wealthcare "Goldilocks" Scenarios

	AGGRESSIVE	CONSERVATIVE	TYPICAL "NEGOTIATED" PROFILE
RETIREMENT AGE:	60	65	62
RETIREMENT INCOME:	$100,000	$75,000	$87,500
ANNUAL SAVINGS:	$10,000	$25,000	$17,500
RISK (STOCK/BOND):	30/70	60/40	60/40
ESTATE:	$1,000,000	$0	$500,000

Earlier, we mentioned that while Harry and Sam have identical profiles, *their priorities* differed. Interestingly, the negotiated profile gives them sufficient confidence (92% probability) that they will achieve these "negotiated" goals. If the negotiated profile happened to be their "current plan" we couldn't help Harry or Sam, other than by asking them to make further compromises (more like their conservative plan) thereby making their plan "better" (99% confidence vs. 92%). But, if their conservative plan was their "current" plan, then the negotiated plan would be "better" because it asks for less compromise but still has a high confidence level. There is obviously something wrong here. How can the conservative plan be better (higher confidence level) if the negotiated profile is "current," but if the conservative profile is the "current" plan, the negotiated profile is better (sufficient confidence of achieving higher goals)?

This is exactly what is wrong with trying to do “better” than current. While *either* the conservative or negotiated can be *sold* as being better than the other, neither of them are “just right” for Harry or Sam. It depends on their priorities. It is not our job to make this decision for the client. *It is our job* to help the client *achieve what they prioritize*. Here is where Harry and Sam totally diverge and why none of these scenarios are “just right,” although some are “better” than others.

PRIORITIZING PRIORITIES

Sam, terrified by the markets and completely focused on the promise he made to his father on his deathbed of making sure that a $1,000,000 inheritance passes to his children, has a totally different set of priorities than Harry. Harry has worked hard his whole life, neglected time with his family, hates his job and wants to retire as soon as possible. While he would like to leave an estate, he believes the kids should take care of themselves and believes they would value seeing him more over an inheritance that may come to them. Harry would like to start taking some vacations with his grandchildren, but this would limit additional savings he would have available until retirement. Once retired, he would like to continue these vacations but would sacrifice them if it meant more time with the grandchildren while they are young. Harry, like Sam, is fearful of volatile markets.

With identical profiles, there are some in our industry that would argue that “answers” (or our advice) should be the same. This is the same unenlightened perspective of those who believe our tools should give us the answer. The “right” answer needs a *priority* to determine what is right. If I programmed our system to automatically take these profiles and recommend that the client compromise all of their goals as much as possible, I have simply set the priority to be the highest probability of success. This ignores how material these choices may be (i.e. take twice the risk for a 2% improvement in odds of success) and, more importantly, ignores what may be more important to the client simply because my tool has been programmed to achieve the highest probability. My system, and therefore my priorities, is at the expense of my client. *Any system* that “solves” for such answers is serving its maker at the expense of the client.

Likewise, perceiving this problem, we could program our system to compromise the client’s goals. Not to the extreme of producing the highest probability of success, but nonetheless to produce a sufficient probability of success. The system could take the profiles and adjust the goals to a level that produces a 90% confidence level. This has the same effect as designing a system that automatically alters the way clients will live their life and trumps what may be important to that client.

Systems that solve for savings, asset allocation, etc. may produce results “better” than “current,” though they do so at the expense of people’s lives. This violates the premises of Wealthcare, of avoiding undue compromises to a client’s lifestyle, and often subjects him to unnecessary risk.

If we focus on doing better than better, in Sam’s case we find it is possible to achieve his most important goals, avoiding risk and achieving an estate, with confidence. (*Exhibit 3*)

In Harry’s case, we focus on hitting on early retirement and avoiding unnecessary risk. (*Exhibit 4*)

These results are easy to produce. They did not require the clients to produce any account statements. The profiles we used were only three pages long, were easy, and could be completed from the top of a client’s head. There are no laborious data inputs for each security in order to analyze the client’s current allocation (which will change tomorrow). It is easy for Harry and Sam to see how these plans meet their goals and priorities.

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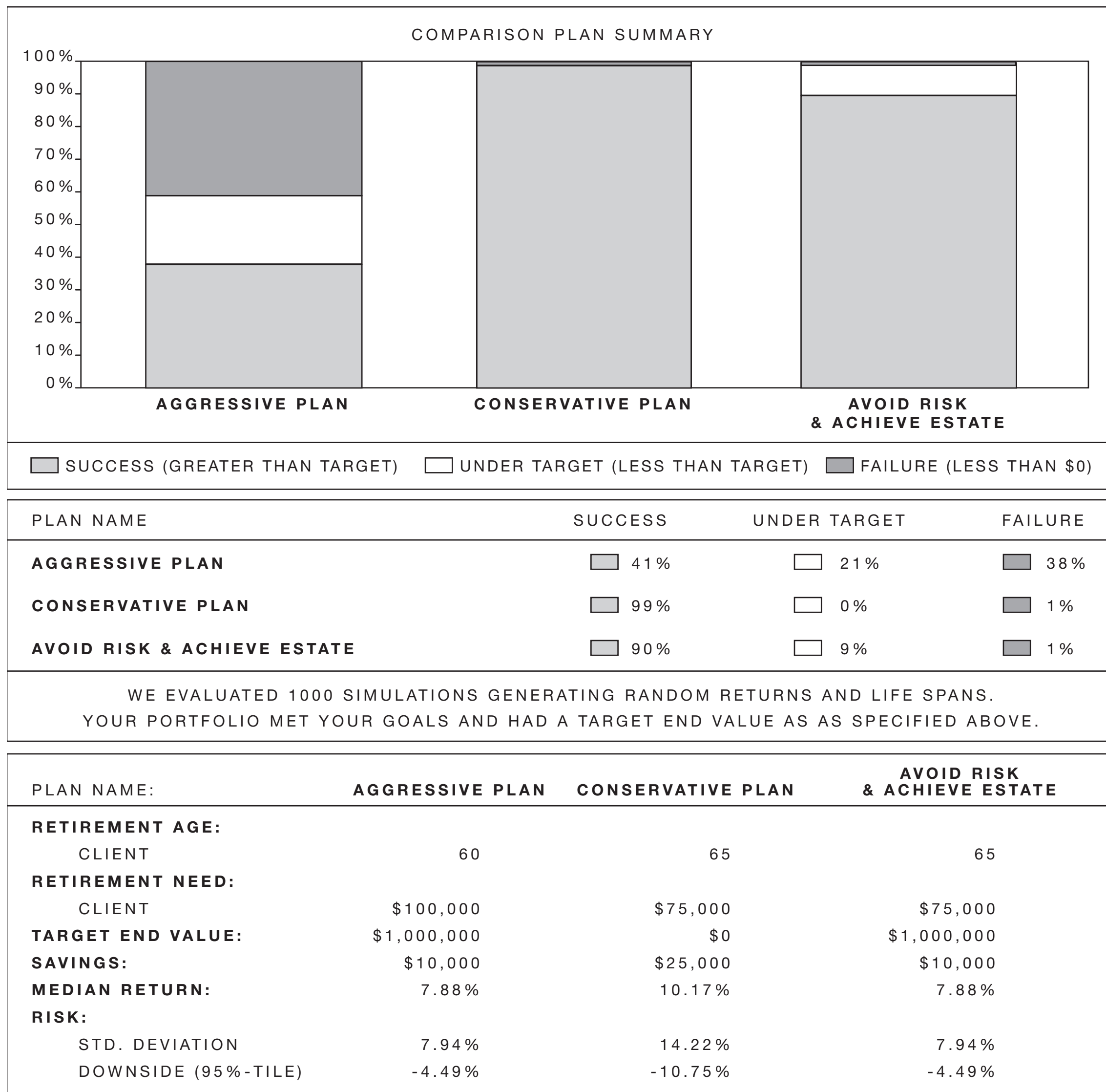
All of this is easy except for one piece…it is difficult to let go of old habits. It is hard to become the person responsible for meeting the client's goals when for so long we've haphazardly allowed our tools to decide what should be important to the client. It is difficult to discuss ideal scenarios when for so long we have focused on negotiation. It is hard to put our minds in a place where we are focused on doing the best we can do when for so long all we've attempted was trying to do better.

This is the hard part and no tool will ever replace this human element. It is, however, the future of financial advice.

Exhibit 3: Success Summary Chart — Sam Client

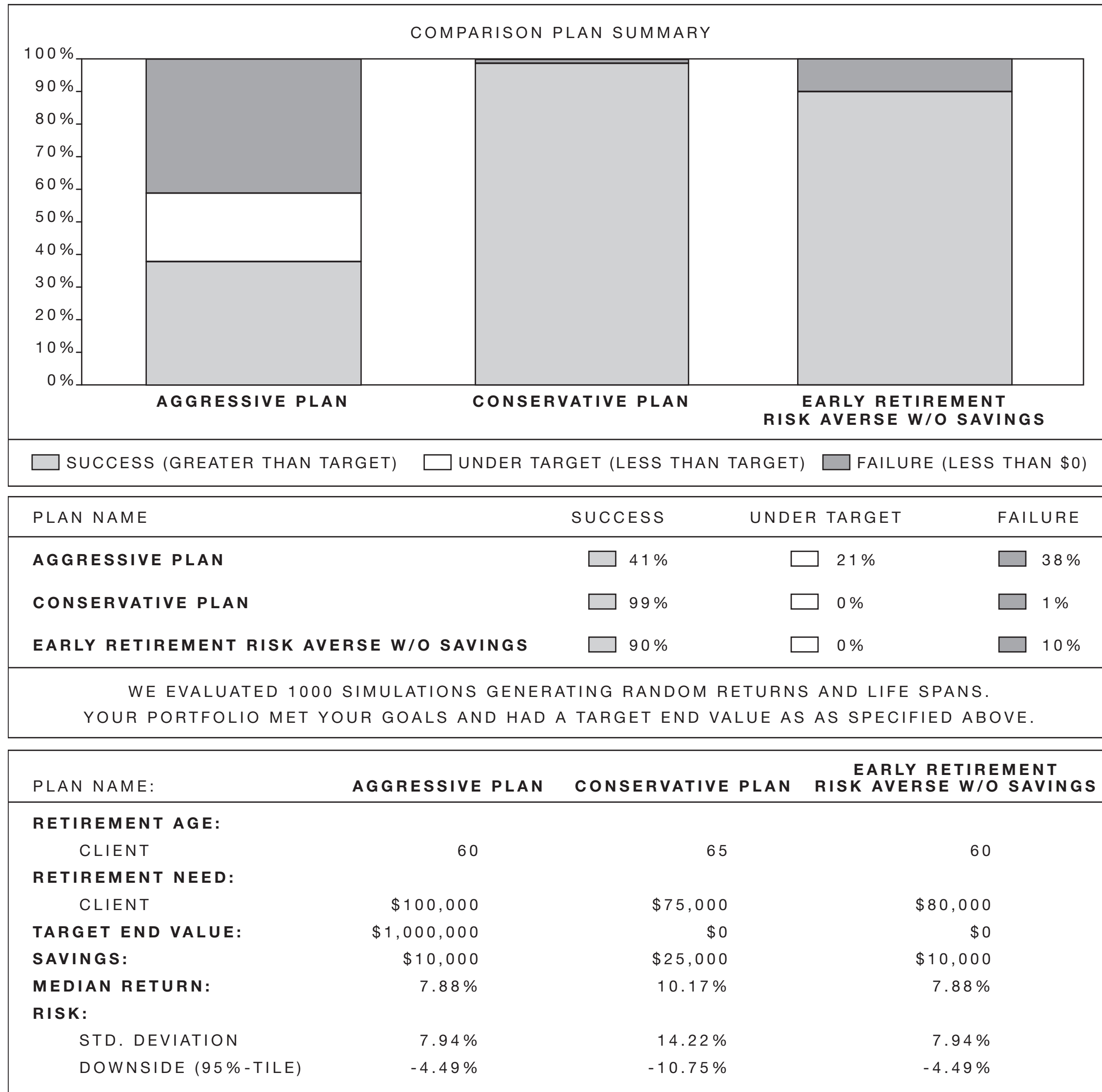


PLAN NAME	SUCCESS	UNDER TARGET	FAILURE
AGGRESSIVE PLAN	41%	21%	38%
CONSERVATIVE PLAN	99%	0%	1%
AVOID RISK & ACHIEVE ESTATE	90%	9%	1%

WE EVALUATED 1000 SIMULATIONS GENERATING RANDOM RETURNS AND LIFE SPANS.
YOUR PORTFOLIO MET YOUR GOALS AND HAD A TARGET END VALUE AS AS SPECIFIED ABOVE.

PLAN NAME:	AGGRESSIVE PLAN	CONSERVATIVE PLAN	AVOID RISK & ACHIEVE ESTATE
RETIREMENT AGE:			
CLIENT	60	65	65
RETIREMENT NEED:			
CLIENT	$100,000	$75,000	$75,000
TARGET END VALUE:	$1,000,000	$0	$1,000,000
SAVINGS:	$10,000	$25,000	$10,000
MEDIAN RETURN:	7.88%	10.17%	7.88%
RISK:			
STD. DEVIATION	7.94%	14.22%	7.94%
DOWNSIDE (95%-TILE)	-4.49%	-10.75%	-4.49%

Exhibit 4: Success Summary Chart — Harry Client



PLAN NAME	SUCCESS	UNDER TARGET	FAILURE
AGGRESSIVE PLAN	41%	21%	38%
CONSERVATIVE PLAN	99%	0%	1%
EARLY RETIREMENT RISK AVERSE W/O SAVINGS	90%	0%	10%

WE EVALUATED 1000 SIMULATIONS GENERATING RANDOM RETURNS AND LIFE SPANS.
YOUR PORTFOLIO MET YOUR GOALS AND HAD A TARGET END VALUE AS AS SPECIFIED ABOVE.

PLAN NAME:	**AGGRESSIVE PLAN**	**CONSERVATIVE PLAN**	**EARLY RETIREMENT RISK AVERSE W/O SAVINGS**
RETIREMENT AGE:			
CLIENT	60	65	60
RETIREMENT NEED:			
CLIENT	$100,000	$75,000	$80,000
TARGET END VALUE:	$1,000,000	$0	$0
SAVINGS:	$10,000	$25,000	$10,000
MEDIAN RETURN:	7.88%	10.17%	7.88%
RISK:			
STD. DEVIATION	7.94%	14.22%	7.94%
DOWNSIDE (95%-TILE)	-4.49%	-10.75%	-4.49%