ViewPoints

Goals-Based Planning – Is it a free pass for your advisor?

Entasis

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Many papers and articles have been published in recent years suggesting that financial representatives should "change the conversation" they have with their clients to a goals-based discussion. The major change with this method is to pivot from a focus on client account performance, to whether or not the client is on track to meet their long-term goals.

At the surface, many of the reasons for changing the focus of the conversation to goals-based planning make a lot of sense. It turns a client's attention to the long-term, which is important considering society's increased focus on whatever is newsworthy at the time. Another reason is that studies have suggested that a goals-based approach increases the amount people save for retirement. Increased savings in an age of consumption is certainly a positive.

However, like many other concepts in the financial industry, my concern is that the original intent of a goals-based discussion has morphed into a more simplistic, potentially self-serving interpretation for some financial representatives. Essentially, it creates a justification to avoid discussing a client's account performance altogether.

Taken at the more simplistic level, the goals-based planning concept implies that as long as a client is on track to reach their retirement goals, underlying account performance should not be a focus. This is where I take issue. Why? Because I do not believe that account performance and progress towards long-term goals are mutually exclusive. Both aspects need to be discussed. Furthermore, foregoing a discussion about account performance implies that the investment management portion of the relationship with your advisor is not important. Said differently, as long as you're on track towards your long-term retirement goals and there's a friendly voice on the other end of the line, all is well. Not true.

The financial advice industry has made strides recently towards better transparency on fees (still a lot of work to do) and other issues. However, I believe the industry is still not nearly as transparent as it should be regarding individual client account performance. While performance may be accessible to most clients, I believe it should be taken one step further by displaying and discussing client account performance relative to a suitable blended benchmark. In my opinion, this should be a standard practice.

One reason it is important to display performance relative to a benchmark is because it is a way to measure the long-term effectiveness of the investment advice from an advisor.

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Summary

In theory, goals-based planning for clients makes a lot of sense. Make long-term goal achievement a priority relative to account performance.

Our concern is that the original intent of goals-based planning has morphed into a potentially self-serving interpretation for some financial representatives.

We believe the financial advice industry still needs to make significant strides towards better transparency for client account performance against a suitable benchmark.

Many things can be gleaned when performance is examined relative to a benchmark such as fees, suitability of investments and alignment of stated goals relative to portfolio structure.

Good or bad, your advisor "owns" the performance of your investment portfolio. Ask questions and demand thoughtful answers. Don't give them a free pass.

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Consider the following hypothetical examples.

- **Client #1:** A client's account has a long-term return goal of 5%. The client's account finishes with a net gain of 5% for the year, but the client's benchmark gains 7.5%.
- **Client #2:** A retired client is seeking investment income of $50,000 per year on a portfolio with an initial value of $1,000,000 (5% income). At the end of the year, the portfolio has generated $50,000 in income, but the ending value of the portfolio is $900,000.
- **Client #3:** A client's portfolio gains 12% (net) for the year, while the client's benchmark posts a return of 5%. The client's long-term return goal is 7%.

In all three examples, the client achieved their investment goals. Should that be the end of the story? Has the advisor done a great job? Possibly. But does your opinion change after you consider the additional information for each of the above accounts in the list below?

- **Client #1:** The client pays an 1.5% annual fee to their advisor and the advisor also collects commissions (which equated to an additional 1% for the year) on trades in the account.
- **Client #2:** The broad equity market suffered a severe correction during the year and the client's blended benchmark finished with a decline (on a total return basis) of -10%.
- **Client #3:** Based on the client's risk tolerance and factors discussed with their advisor prior to investment, the client expects to be invested in a conservative mix of equities and fixed income.

With the additional information provided above, a more accurate assessment can be made. At minimum, providing account performance relative to a suitable blended benchmark provides a client with a better framework for questions they should ask their advisor. See below.

- **Client #1:** The performance comparison demonstrates that investment performance for the client's account was roughly in line with the client's blended benchmark on a gross basis (before fees). However, the excessive nature of the advisor's fees (advisor fees/commissions) resulted in poor relative performance of the client's account relative to the benchmark. In other words, investment management was reasonable. The real culprit for poor relative performance was the advisor's excessive fees. A client should know this.
- **Client #2:** Taking into account the performance of the broad equity market, the advisor did a good job at managing the portfolio. The client's portfolio held up better than the broad equity market (on a total return basis – total return includes income in the performance calculation). In addition, the client received the necessary income for the year. In total, the client performed well relative to their benchmark.
- **Client #3:** The client's portfolio performed very well relative to their benchmark, but the relative performance raises a number of questions. Why did the client's account perform so well relative to their benchmark? Is the advisor taking an inordinate amount of risk in the portfolio relative to the client's investment policy statement? Especially considering the expected conservative nature of the portfolio? Few people will complain about good performance, but sometimes good performance relative to a benchmark raises flags as well.

As demonstrated above, many things can be gleaned when performance is examined relative to a benchmark (fees, suitability of investments, alignment of stated goals relative to portfolio structure, etc.). In other words, this isn't simply an exercise of lining up two performance numbers (portfolio and benchmark), determining which of the two numbers is larger, and then congratulating or criticizing your advisor. Instead, the real value comes from the questions and discussions around what the numbers mean.

Account performance matters. And good or bad, your advisor "owns" the performance of your investment portfolio. Ask questions and demand thoughtful answers. Don't give them a free pass.

Charles Batchelor, CFA

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