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Top Three Ingredients for Developing a Plan-Based Investing Approach

Advisors ultimately have one job: align the plans and investments to clearly defined client goals and aspirations

By Scott Rawlins

Establish a game plan and have the patience and perseverance to take the necessary steps with your clients to achieve it.

In football, coaches spend each week during the season studying their opponent's various strengths and weaknesses, while factoring in what their own team does well to arrive at a game plan – which will then be implemented and fine-tuned in practices leading up to kickoff. Game plans are comprised of tactics defined by a set of broad, team-based goals.

Not included among such goals, however, are arbitrary benchmarks, like scoring a predetermined amount of points or throwing for a set number of yards. Obviously, the objective is to score, and typically, teams want to move the ball through the air, but if the game plan is properly executed, such things generally take care of themselves.

Advisors should think about taking a similar, plan-based approach with their clients. Obviously, this takes longer than a week or even a year. But the same general principle applies – don't get lulled into setting arbitrary benchmarks like beating an index or achieving a specified level of return each year. Simply establish a game plan and have the patience and perseverance to take the necessary steps with your clients to achieve it. Everything else will take care of itself.

So what are the top three key elements of a successful plan-based investing process?

Agree with the client about what the advisor relationship entails and what it doesn't from the outset, to prevent reactive, emotional decisions

According to a recent Dalbar analysis of investor behavior, equity fund investors have underperformed the S&P 500 by 4.2% over the last 20 years. [1] Investors allowing emotions to get the better of them is the only way to explain this gap. When markets take a dip, the behavioral forces become too strong and they sell. Then when the environment improves, they come back. This phenomenon is the inverse of the classic 'buy low and sell high' adage, and it's costing investors dearly.

The first step towards a plan-based approach – and one of its primary benefits – is to force clients to cast aside emotion and take a longer-term view of their goals. At the top of each engagement, the advisor should sit down with the client and agree about what the true plan-based objectives are, and as part of that agreement, commit to ignoring what the day to day, and even month to month gyrations in the markets may be.

In essence, this approach – enshrined from the outset of each client relationship by the advisor – keeps investors from making knee-jerk decisions. It's up to the advisor to make it abundantly clear to the client from the start of the relationship that the advisor's job is not to achieve certain quantitative growth metrics based on an index or demonstrate outsized performance year over year. Not only does this approach do nothing to address long-term goals, but it invariably causes clients to take on undue risk.

Recognize that it's all about cash flow

At the most basic level, a plan-based approach is about building a nest egg large enough to support a client's future cash flow needs. Clients typically worry about a range of financial planning challenges, like putting away enough for retirement, paying for long-term care or saving for their children's college education. But fundamentally, such issues deal with the same overriding concern – having enough money to last a lifetime.

The next critical ingredient of taking a plan-based approach is ascertaining what the client's current cash flow needs are. But be aware that coming up with an answer might be more difficult than it sounds on the surface, since the average American typically has very little awareness of how much they spend per month. A helpful tip: Instead of asking clients how much they spend, ask clients what they make each month – which they are far more likely to know – and what they have left over at the end of it. The difference is your answer.

From there, follow up with a values-based conversation. What's more important to them as they age, retiring early and spending less or working longer and spending more? There is no right or wrong answer, but their response will help advisors as part of their broader efforts to keep clients focused on where they are against their long-term goals versus reacting to market events and superficial market performance numbers. In this respect, ensuring current cash flow needs are accurate is mission critical to getting your clients comfortable and on board with plan-based investing.

Validating the plan on frequent and regular intervals

Of course, helping a client to understand why and how a plan-based approach is the most effective way forward isn't a one-time event that happens up front and then never needs to happen again. Market corrections are an unfortunate reality of investing, and clients are only human.

And when the markets take a dive, many investors let their emotions take over and, as such, they often feel an overriding urge to sell. This is why advisors need to proactively schedule frequent and regular reviews with their clients to recap long-term goals, current cash flow needs and how things are going within the context of their plan. No matter how sound a long-term financial plan is, if clients don't regularly and routinely hear from their advisor how they are doing with respect to the plan, it's easy for near-term noise from the markets to fill the communications vacuum. Advisors need to understand that it is an ongoing journey when it comes to making sure that clients understand that a plan-based approach is not about picking individual stocks or attempting to ride market waves.

Market performance is not linear. There will be ups and there will downs. It's essential for advisors to team up with a broker-dealer that is capable of delivering technology solutions that enable them to track, in real time, how advisors are performing with respect to each client's individual long-term plan, and thereby put client concerns at ease. Most, if not all firms, have systems that show performance relative to an index. But comparatively fewer have the ability to show performance relative to a client's plan, which requires a higher level of advisor information integration into a brokerage platform.

Collectively, the industry needs change the way it looks at performance. All too often, we get fixated on the latest investment philosophies, sale ideas or other emerging trends. The reality is much simpler.

Advisors ultimately have one job: align the plans and investments to clearly defined client goals and aspirations. This type of goal based investing creates a new dimension of understanding between the advisor and the client. No longer are we benchmarking our investment performance to an impersonal and synthetic market index. We are instead marking a co-authored plan's progress against a personal set of future goals. We know that goals and aspirations change, and we know new obstacles can be introduced.

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[1] Jeffrey S. Williams, Dalbar's 20th Annual Quantitative Analysis of Investor Behavior 2014 Advisor Edition, 3. http://grandwealth.com/files/DALBAR%20QAIB%202014.pdf

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