The Philosophy of Goal-based Investment Planning
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by Dr. Michael Finke, CFP®

By Dr. Michael Finke, CFP®
Dean and Chief Academic Officer
The American College of Financial Services

Most of us view our investment portfolio as numbers on a screen. However, investments represent money that we set aside for some future purpose or goal. Are we investing with that goal in mind?

Viewing investments through the lens of short-term performance offers a limited perspective. We construct portfolios to minimize risk of annual volatility. There is little thought given to how and when the money is actually spent.

If the purpose of our savings is to pay for a spending goal such as a college education or an income in retirement, shouldn’t we focus on how well the strategy helps us meet our goal? This is the essence of goal-based investing. Instead of viewing the portfolio as a monolithic account that exists separate from our real life, think of investments as each having its own purpose. Money is saved in this account to pay for a retirement home at age 67. Another account may fund spending on essential expenses throughout retirement. Each goal has its own amount of acceptable risk. Each goal has its own time horizon.

Why is Goal-based Investing So Valuable?

Goal-based investing is valuable because it helps us understand why we are saving in the first place. If the purpose of the investment is to fund a home at retirement, we can imagine ourselves living in the home. The pleasure we’ll get from the sacrifices made today to live better in the future. We will be able to match the risk of our investments with the flexibility of the spending goal. Are we willing to take more risk in the hope of buying a larger house on the beach? Or are we unwilling to accept the possibility of living in a smaller house? By defining the parameters of the investment goal, we are better able to identify the right amount of risk with our investments.

Many advisors use goal-based investing to help clients focus on the long-term goal in order to avoid worrying about the inevitable short-run volatility from holding a risky portfolio to fund that goal. They can remind a client that losing money this quarter isn’t that important because they won’t spend that money for another 10 or 20 years. Focusing on the long run helps investors avoid the common mistake of moving money away from stocks after markets have fallen.

Most importantly, goal-based planning provides a framework for using tax efficient strategies when deciding where to place investments. If I’m going to buy a house at age 67, what type of account should I invest in? Is a 401(k) the best choice? Should I use funds from a Roth account? These are complex questions that require knowledge of rules and tradeoffs among accounts. And this is where we can identify the most quantifiable benefit of goal-based planning over monolithic investing. Some accounts perform better over shorter and longer time horizons, and others are more useful when taxable income is high or low. Knowing these strategies helps investors get the most from each dollar they invest.

Challenges in Developing Financial Goals

Most of us have financial goals, but we rarely get around to identifying them. This is natural because thinking about the future isn’t something we do every day. It even demands the use of a part of the brain, the prefrontal cortex, that is used to imagine future scenarios. We often don’t invoke the prefrontal cortex to help plan long-term goals, and even when we do it is difficult to prioritize a range of goals at various time periods. We’re particularly bad at estimating how much we need to save in order to fund goals over time.

One of the most important benefits of goal-based planning is simply forcing us to think about what matters most in our lives. Do we really need that special home when we retire if it means we have to sacrifice other goals such as saving for a child’s education? And how much do we actually need today to fund all of our
Because we have limited capacity for imagining multiple future goal scenarios, the process of defining goals, estimating savings needs, and then weighing tradeoffs to meet future goals transports investments from a number on a screen into a tool that makes life better.

**Becoming a Better Wealth Manager**

It’s not just clients that benefit from goal-based investing. Advisors stand to gain an advantage over their competition and position themselves to attract and retain high-net-worth clients by understanding and practicing goal-based investment management, too. With sophisticated robo-advising algorithms capable of hyper-efficient investment picking, the true value an advisor brings to the table today is not an ability to pick stocks, but having the knowledge to develop goal-oriented investment strategies and the experience to guide clients with advice that bears their entire collection of goals in mind.

Goal-based investing is at the core of a new designation being developed by the thought leaders at The American College of Financial Services. The **Wealth Management Certified Professional (WMCP™)** designation, which will be available soon, takes a deep dive into personal investment management using a goal-based approach for managing and planning client wealth.

The WMCP™ curriculum leverages the latest digital learning technology to take students through a customized learning experience. The program won’t focus on creating an investment portfolio, but rather how to use the portfolio as a tool to help clients meet long-term goals. You can watch an informative video and sign up to learn more about WMCP™ here.
