30 April 2015

A Framework for Goals-Based Wealth Management

By Lauren Foster

When did your financial adviser last ask you about your dreams? How about your nightmares?

For Jean L.P. Brunel, CFA, managing principal of Brunel Associates and author of the recently released *Goals-Based Wealth Management*, identifying a client's goals is at the heart of integrated wealth planning. And it is questions about dreams and nightmares that allow advisers to more fully understand what clients hope to accomplish with their wealth.

"These are the goals they want to achieve with the greatest degree of intensity, and their failure to achieve them will be felt with the deepest pain," he wrote in a 2012 article.

The starting point is to understand that individual clients are not like institutional clients and that what works for a big institution cannot simply be overlaid onto an individual client.

"We cannot serve individuals with institutional solutions," Brunel said at the 68th CFA Institute Annual Conference in Frankfurt.

He noted that the institutional process is, in many ways, quite simple:

- **Major purpose**: Single
- **Time horizon**: Single
- **Liabilities, number**: Large
- **Liabilities, individual size**: Small
- **Tax status**: Mostly tax-exempt
- **Asset size**: Mostly very large

“For individuals to be well served by the same process, we must be able to argue that they share the same attributes,” he said. “But do they?”

Here’s a quick comparison for the individual investor:

- **Major purpose**: Multiple
- **Time horizon**: Multiple
- **Liabilities, number**: Small
- **Liabilities, individual size**: Variable
- **Tax status**: Mostly taxable
- **Asset size**: Variable

This has key investment implications. Think about it: An individual investor often has multiple goals over multiple time horizons. The measure of risk is also different when applying a goals-based framework: Risk is not return volatility, but the probability of missing a goal.

“The risk determination when thinking of institutions is totally top down. For the individual, it is bottom up,” Brunel told delegates. “We need to look at risk as an aggregation of bottom-up risk profiles.” In other words, clients with multiple goals and multiple time horizons also have multiple risk profiles.

What this means is that each client should have his or her own goals-based investment policy and perhaps multiple policies. Brunel stressed that one goal can mask another, so it’s crucial for advisers to be good listeners.

How does one set up a process towards implementing a goals-based approach?

It’s an iterative process — markets don’t always do as expected, and goals may change. That said, here are the basic elements:

- Identify and describe the client’s main goals. That includes needs, wants, wishes and dreams, nightmares, fears, worries, and concerns.
- Identify their respective time horizons.
- Identify related cash flows or bullet payments.
- Identify lowest “funding cost” for each goal.
- Derive assets needed to meet each goal.

In sum:

For more on Brunel's work, my colleague Sue Hoover recently put together a very comprehensive summary of resources from CFA Institute, where Brunel explains his ideas in greater detail (excerpted below):

"Psychological Influences on Investor Decisions": Brunel argues that current tools for optimizing private client portfolios are powerful and insightful but clients do not have the time to understand them. In this presentation, he discusses how advisers must take highly quantitative results based on rough answers and adapt them to changing client needs, goals, and risk over a lifetime — in effect, putting themselves in the shoes of their clients to develop a goal-oriented approach to asset allocation.

"Alternative Assets": In this presentation, Brunel questions the industry definition of "alternative assets," suggesting that inappropriate benchmarks are used to measure them. The lower-than-expected liquidity and lower-than-expected downside risk protection of alternative assets mean that proper benchmarks are especially important, and an increased emphasis should be placed on manager selection. The industry has matured, according to Brunel, which means that there are solid opportunities, particularly in relative value.

"Goals-Based Wealth Management in Practice": The 2008 global financial crisis created opportunities for advisers ready to meet client concerns by focusing on those clients' goals. In this article, Brunel discusses ways that wealth managers can address family issues, using goals-based wealth management concepts to generate specific portfolios driven by the client's expressed goal. Brunel's model allows for a high degree of flexibility and responsiveness to client needs while retaining a practical level of standardization.

"Is a Behavioral-Finance-Based Allocation Really Suboptimal?": Modern portfolio theory works marvelously in a world of institutions, but individual investors do not make decisions according to the logic of financial theory. According to Brunel, high-net-worth investors need an approach that reduces the likelihood of suboptimal performance while recognizing their unique behavioral tendencies. In this presentation, he discusses how a goal-based allocation that is adjusted to include overall risk optimization can assemble portfolios that are better matched to client intuition, which means portfolios that clients are more likely to accept and retain.

"Goal-Based Asset Allocation": In this presentation, Brunel explores a sequential approach to setting goals, stating that advisers need to change the definition of risk to mean "the probability of not achieving one's goal." According to Brunel, integrated wealth planning for individuals must evolve into an analysis of the client's goals — what matters to the family, what are the worst nightmares, and what are the most cherished dreams. He further discusses the skills necessary to identify and quantify assets for each goal to match its risk profile.

“Private Asset Management or Private Wealth Management?”: Private asset management can be viewed as a separate discipline from private wealth management, even though the two terms are frequently used interchangeably. In this article, Brunel explains that private wealth management must go beyond the asset allocation and tax efficiency that is the focus of private asset management, encompassing more extensive issues and introducing more complex interactions. The larger number of factors involved leads to an exponentially larger number of possible interactions.