Goals Based Advice

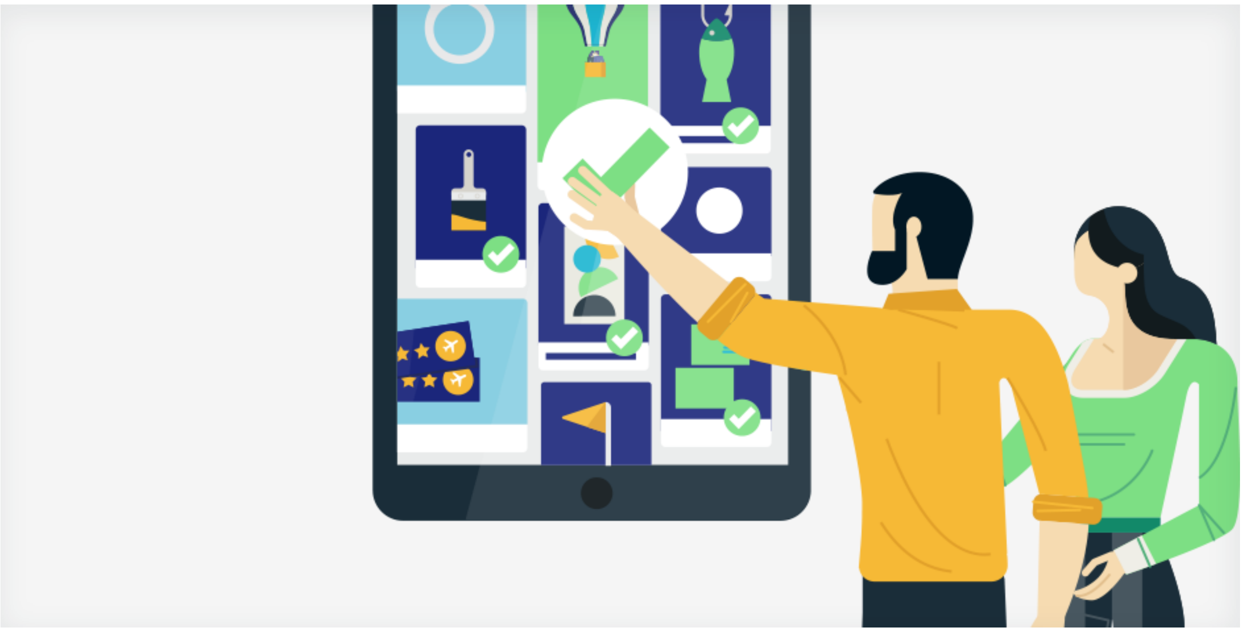
White paper by Advice Intelligence (ai)

Financial planning, by definition, is a goals-based conversation

Goals based advice may be a new phrase for some, but it addresses an issue that's been around for a long time – namely, connecting a client's individual goals directly to strategies and their portfolio.

As well as improving a client's chances of achieving their dreams, goals-based advice also makes the entire advice process more engaging and relevant. By placing their goals front and centre, clients are constantly reminded of the 'why' that's driving them and gives them a greater sense of control over the future.

This sense of connection to long-term goals is hard to achieve using any other methodology. The main problem we've faced? Until now there has been no financial planning software that makes goals-based advice an easy and interactive process.



Why are financial goals critical?

Goals are outcomes focused

Goals require clients to look forward and ask what they'd like to achieve across their projected life journey. Once they're in this mind set, it's much simpler to map back to optimal advice strategies and investments.

Goals facilitate scenario planning

They help facilitate the advice conversation, illustrating to clients the probability of what they 'can' or 'cannot' achieve based on current behaviours and circumstances. More than that, this approach allows clients to visualise how different trade-offs and future events may impact their future, from life events to economic crashes.

Goals improve life achievements

Goals based advice demonstrates the true value of advice. By allowing clients to directly track advice strategies to their specific life goals, they're able to identify whether they're 'on' or 'off' track throughout every step of the journey.

Goals-based advice creates an environment where there is greater clarity about what the client wants and how financial advice can be delivered to meet those desires. You can read more about this in a recent blog titled [Goals Based Advice is not an own goal.]

Did you know...

- 75-85% of people fail to achieve their goals.
- 70% of people don't know their goals.
- 25% of people have goals, but don't have them written down.
- ONLY 5% of people have written goals.

Why people don't set goals...

1. They don't know how.
2. They are scared of failing or succeeding.
3. They don't realise its importance.

Why people don't achieve their goals

1. Unresourcful language, self talk and/or cognitive behavioural patterns.
2. There are no tools that help guide, educate, act, track and motivate.

The behavioural science of Goals Based Advice

One inherent problem with goal-setting is related to how the brain works. Recent neuroscience research shows the brain works in a protective way, resistant to change – therefore, any goals that require substantial behavioural change, or thinking-pattern change, will automatically be resisted.

The brain is also wired to 'seek rewards' and 'avoid pain' or discomfort, including fear. This means that, when fear of failure creeps into the mind of the goal setter, it works as a 'de-motivator', encouraging them to return to known, comfortable behaviour and thought patterns. Conversely, when excitement and elation is in the mind of the goal setter, it acts as a 'pro-motivator', driving them to pursue those positive feelings of reward and goal achievement. This means that unless the goal-setting process can be made to feel positive in some way, it can be an uphill battle.

Another challenge around goal-setting is the fact that it needs to be tangible in some way. In order to set a goal, a person needs to have a tangible 'outcome' in mind. This may be something they can physically see, feel, hear, or sense as an experience; a combination of Visual, Auditory and Kinesthetic (VAK) stimulation.

Lets take a look at the Behavioural Science of Goals Based Advice.

Emotional response drives human behaviour.

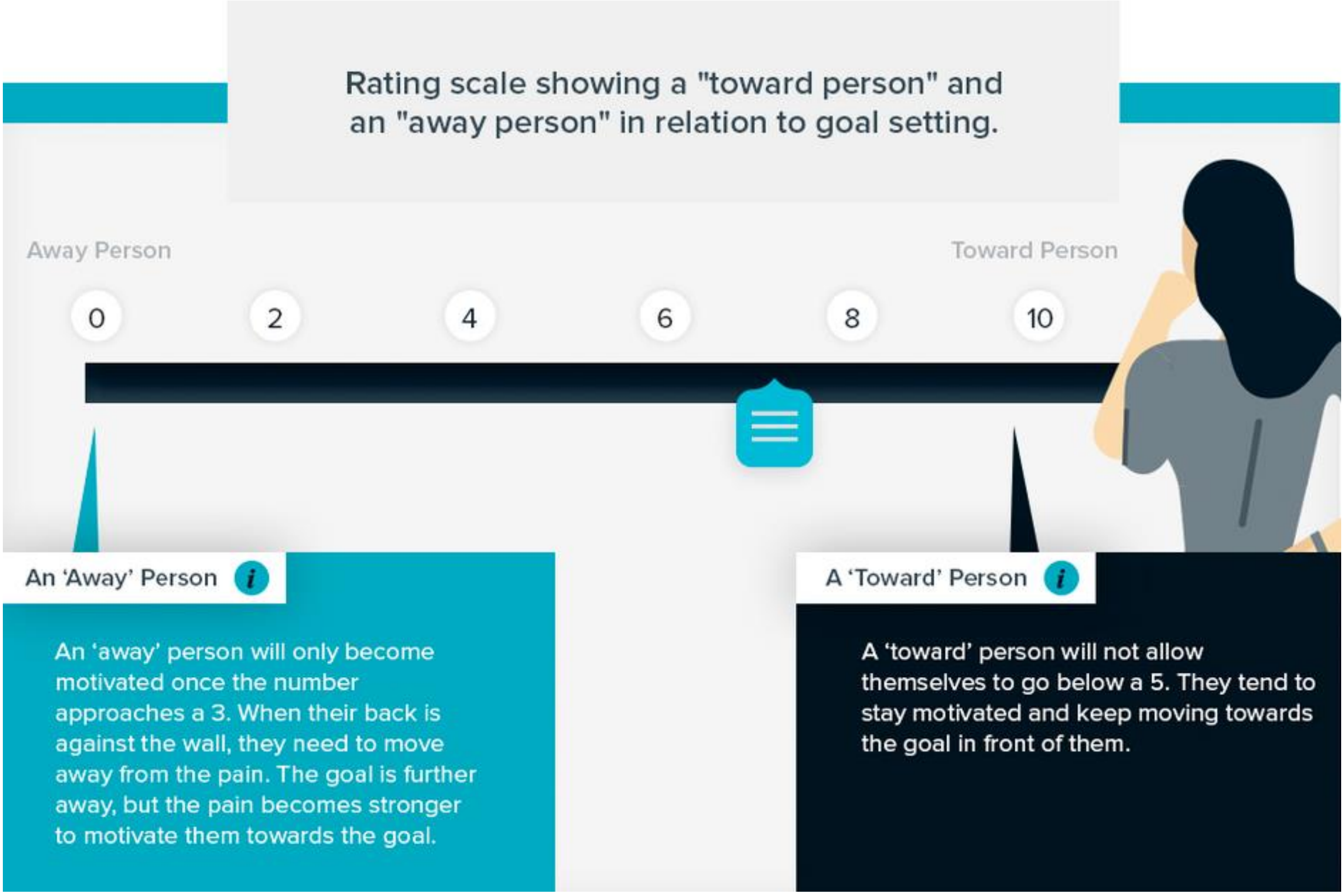
Significant Emotional Events (SEE) don't just affect us emotionally, they can dictate our financial decisions, patterns and behaviour. Not only that, money is a subject that elicits strong emotional responses in all of us; feelings that shape our actions for better or worse.

People who have been exposed to seeing money in a positive light are more likely to seek out more of these positive feelings and experiences. They will attract people with similar belief systems and values around money, and they will work 'towards' achieving outcomes and goals, as long as it provides them with positive emotions and its pleasurable. This 'toward response' means they'll prefer to set goals related to the things they desire and want to have in their lives.

In contrast, people who have had exposure to negative emotions and have been in a negative environment when it comes to money, they will tend to dislike or even avoid thinking or talking about money. They will tend to be driven to take action 'away' from pain and negative emotions, and this 'away response' means they tend to set goals linked to the things they're afraid of happening (or losing).

The good news? Everyone is capable of setting goals, whether they're motivated 'toward' or 'away'. It's just a matter of firstly understanding their motivation system. a.i.'s financial planning software determines a persons motivation system within the Behaviour Profiler feature.

An deeper explanation on motivational patterns can be viewed **here**.



Fixed and Growth Mindset.

Having a fixed mindset, as the name implies, increases the limitations you have in your life. Optimists believe the glass is half full whilst pessimists believe it's empty. The same can be said for those with a fixed mindset vs a growth mindset.

A leading Stanford University psychologist Dr Carol Dweck, found that those with fixed mindsets believe their intellect is static, whilst those with growth mindsets strongly affirm their intellect evolves.

Dr Dweck's videos on Developing Growth Mindsets and Teaching Growth Mindsets provide a guide into understanding and helping clients that are challenged by a Fixed Mindset.


The Fixed & Growth Mindsets
Fixed Mindset
Leads to a desire to look smart and therefore a tendency to...
Growth Mindset
Leads to a desire to learn and therefore a tendency to...
Challenges
avoid challenges
embrace challenges
Obstacles
Gives-up easily
Persists
Effort
sees effort as fruitless
effort is path to mastery
Criticism
ignores useful feedback
learns from criticism

Breaking down the goal-setting process

According to goal-setting theorist, Edwin A Locke, the goal-setting is experienced within five human psychological stages – and these can be directly related to the goals-based advice process.

1. Environmental stimuli.
This is the environment of a person's home; as an example: Australia, Suburb, Tribe, Family.

2. Cognition.
This a person's financial intelligence. People often get stuck here because they don't have the language to 'talk finance', and may also lack awareness of their current financial situation (for instance, they may live beyond their means in constant deficit or they may have a surplus but don't know how to invest or compound). *The people education part of goals-based advice.*

3. Evaluate/feedback.
This is where people need to look at their current and projected financial situation, and ask: what if things were different? What if it stays the same? This evaluation requires simulation and scenario planning of 'what if' and 'tradeoffs'. *The discovery & engagement part of Goals Based Advice.*

4. Set Intentions.
This is the 'goal-setting' part. It is extremely important for people to gain clarity of their financial outcomes; goals must be specific, measured, timed and realistically achievable. This is where the Reticular Activating System (RAS) of the brain gets activated, changing our energy quantum field. *The development of a Goals Based Financial Plan.*

5. Performance.
This is where people require a feedback loop, where there are positive incentives and rewards. The adviser and client can make ongoing adjustments together until the achievement of the goal is reached. *The ongoing review & tracking part of Goals Based Advice.*

An article on Dr Edwin Locke and Dr Gary Latham goal setting theory takes a deeper dive into the 5 principles of goal setting; Clarity, Challenge. Commitment. Feedback and Task complexity.
The below TED talks on the subject matter of 'goals' highlights the importance of goal setting.

Secret of success is setting the right goals by John Doerr
A goal without a plan is just a wish by Cheryl Travers
Four keys to goal setting by William Barr

There are several factors advisers need to be aware of to help their clients make their goals more achievable

- **Make it specific** (and realistic)
- **Determine the timeframe** (is it short, medium or long-term?)
- **Prioritise it appropriately** (is it essential or a nice-to-have?)
- **Make it measurable** (how will you know when you have achieved the goal?)
- **Identify the risk** (acknowledge what 'could' happen and plan/prevent)

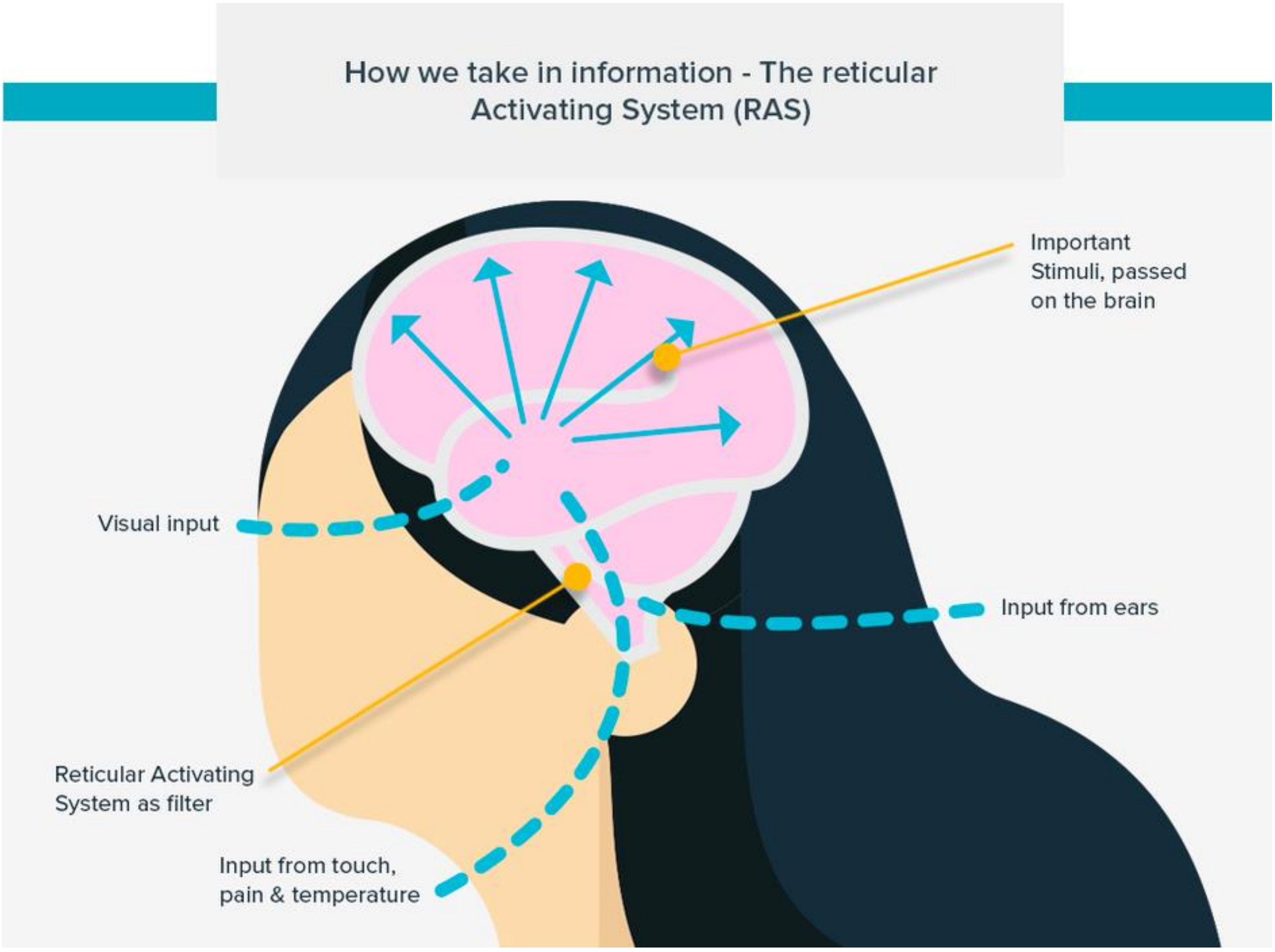
Why a clear mental picture of goals is so important - Reticular Activating System (RAS)

The RAS is a filter in the human brain, to all our receptors, our vision, hearing, touch, taste and smell. This system sits in the centre of the brain, lighting up the entire neurology of the brain, and continually determining what input is important to us. Essentially, the RAS enables the brain to focus on what is necessary, and to delete what is not necessary.

During the goal-setting process, the RAS becomes activated as we seek clarity on what matters most. The brain will then delete, distort and generalise information, so we can begin to hear, see and feel our goal around us. One example is that, if you want to buy a black Mercedes car, you will start to see them everywhere!

When you can see, hear and feel the goal in this way, your ability to achieve the goal becomes more successful, taking it from an idea to a clear reality. The more abstract the goal, the less likely the goal will be achieved; the more clarity of a goal, the higher chance of success.

People can also use meditation to help visualise their goals and create a daily or weekly practice to maintain a clear picture of their goals within their mind.



Why Time Horizon in Goals Based Advice is so important

Getting people to think long-term has so many empirical benefits. Research has shown that mental time horizon correlate with more than just savings behaviour; it has the same effect in cash and debt-management. People who think ahead are more likely to keep track of their personal finances and spending, and promptly pay their bill – they're even more likely to carry low to zero balances on their credit cards.

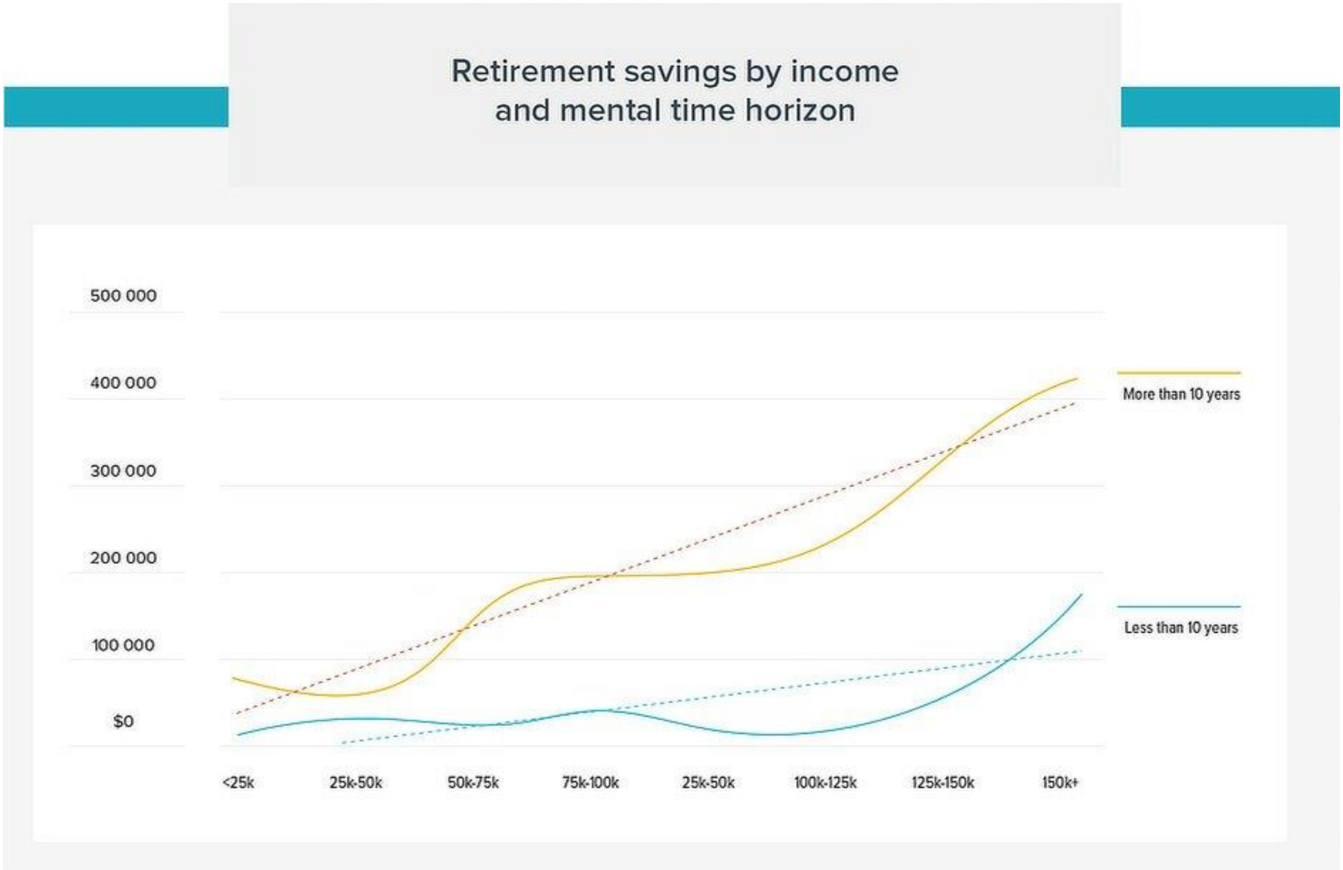
Our brains are hard-wired to give more weight to immediate needs, and to discount the future. The shorter a person's mental time horizon, the more they will find long-term saving to be a challenging and painful task.

With this in mind, it's always easiest to start the goals based advice process by looking at the client's short-term goals (where they want to be financially, within the next 1-2 years?) and extend outward toward long-term goals (five years, 10 years, 20 years). We must always anchor this with their retirement age and life expectancy. The further ahead a person thinks, the better their financial behaviour, and the less they'll worry about their financial future.

People who think further into the future tend to save more frequently and build more wealth.

Clearly, time IS money.

In the graph below, people who think further ahead (orange line) saved more than those with shorter time horizons (blue line). It also had the same effect with regard to cash and debt-management.



Why empowering clients in Goals Based Advice is key to unlocking the emotional & behavioural health around finances

People who feel empowered in their financial lives experienced more joy, peace, satisfaction and pride. Those who felt disempowered helpless, hopeless or stuck) were, overall, less happy.

Not surprising, really – but what is interesting is that goals based advice actually provides a bridge to take clients from one state to another.

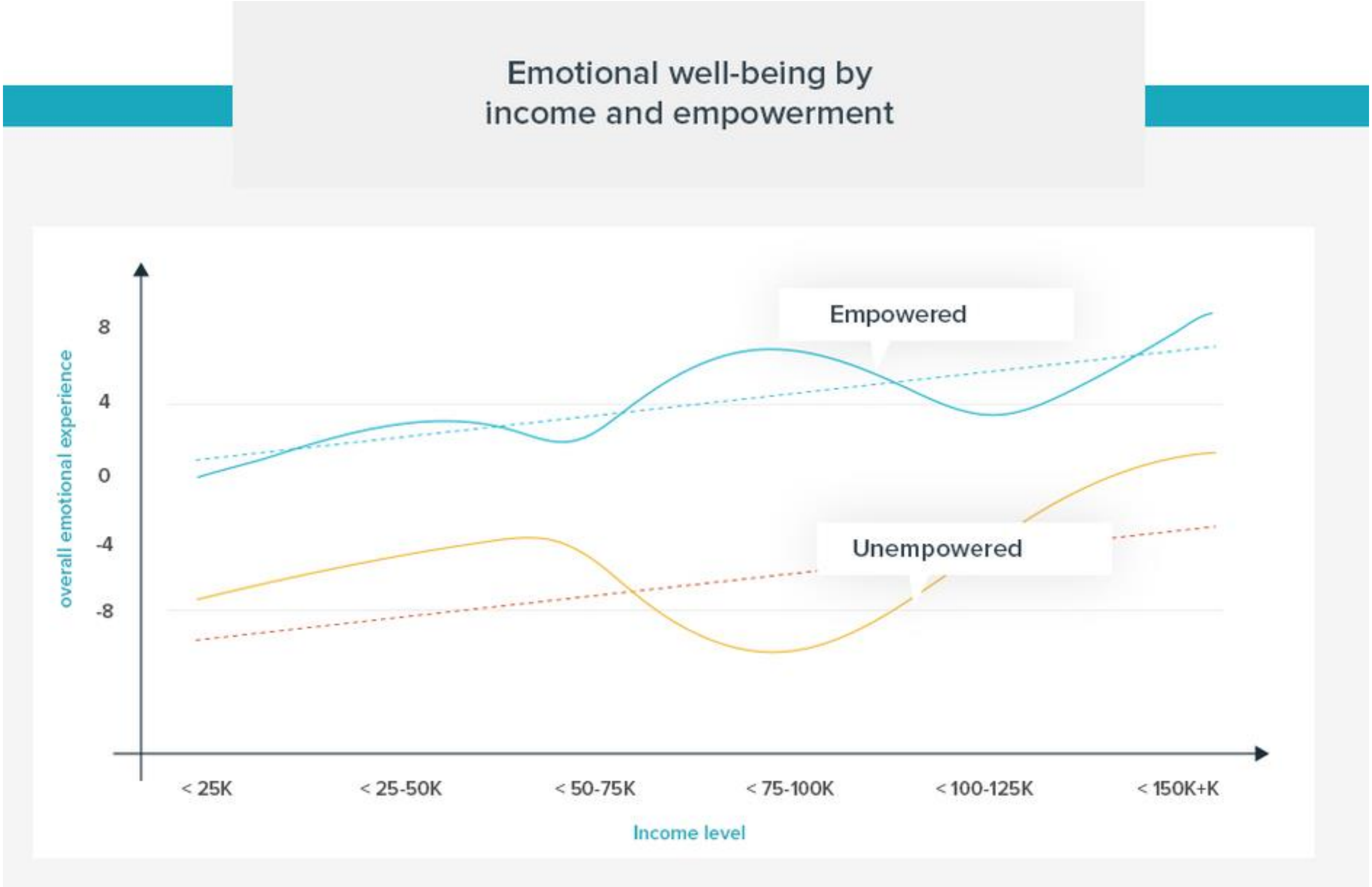
By enlightening people through financial literacy & education, and helping them understand and visualise what's possible, we are empowering them to play an active role in their futures. The very act of setting an achievable goal is empowering – even more so when you give that same person a way of tracking their progress.

Rather than feeling like a victim at the mercy of their financial circumstances, they see the impacts of their actions and decisions – inspiring them to step up, take responsibility, and actually relish the improvements this brings about.

In the graph below, the blue line represents people who agreed with the statement: "I create my own financial destiny." The orange line represents people who said instead that they: "Have very little power" in their financial lives.

Sarah Newcomb Ph.D - Behavioural Economist from MorningStar, explains her research and why money doesn't buy happiness, but empowerment does.

Her whitepaper on Rethinking Financial Health provides incredible insights into how financial behaviour and emotional well-being are affected by two simple mental factors; emotional well-being and own economic stability.



Source: MORNINGSTAR

The neuroscience behind why Statements of Advice are not engaging for consumers

Words have no power unless you know what they mean. With this in mind, it's no surprise that traditional Statements of Advice (SoA) aren't a powerful or appealing way to deliver information – after all, they are produced in a language and format that most people simply don't understand. Far from helping educate clients, this 'foreign language' only seeks to alienate and confuse them.

For people to 'hear' financial advice, we have to deliver it in a way that can be heard and understood – regardless of people's preferred leaning style. As outlined in Howard Gardner's Multiple Intelligences Theory, people are capable of learning in a range of ways: via words and language (linguistic), via numbers (logical-mathematical), through sound (auditory) or through images, diagrams or videos (visual).

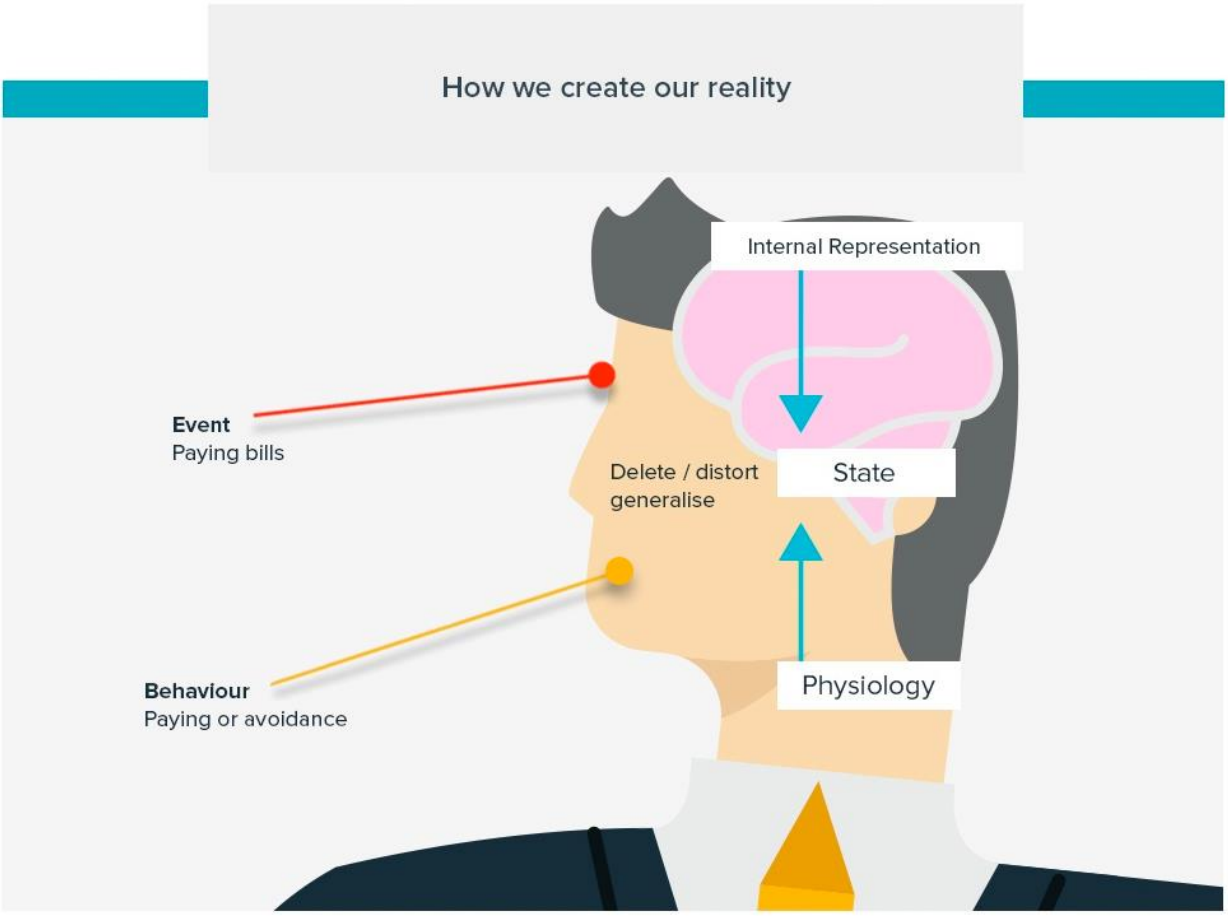
Archaic paraplanning software systems continue to be the backbone of the industry. Financial planning software simply lacks a consumer facing experience. Thanks to technological constrains, the consumer experience is manual, paper-based, static and financial modelling is based on linear methodologies.

The future of financial advice needs to change to meet clients' needs and become the 'smart tech' that is now part of daily life. It needs to reflect the myriad of ways people learn - and speak the language consumers speak.

By transforming the old static SoA into a dynamic, interactive financial plan - via a smart phone app, we can improve client engagement and tailor advice towards consumers.

A recent submission by Advice Intelligence to ASIC by stated that ASIC's SoA measures don't go far enough, questioning if paper-based SoA's are in the best interests of the consumer?

Deloitte Australia's recent Mobile Consumer Survey 2017 explains that 88% of consumers have a smart phone, so why aren't financial plans delivered on smart phone? On an app just like consumer banking. Our white paper on; Everything you need to know about financial planning software, provides further insights into a new world of SoA's through interactive financial planning.



Today's consumer is driven by mobile technology, making 89% of decisions on a mobile device.

This really begs the question: why isn't financial advice being delivered via a smart phone device?

Goals based customer experience

Goals based customer experience & multi-dimensional modelling

Modelling a household's financial circumstances and future scenarios has always been an important tool for financial planners. It is a critical element within the customer experience, to develop a robust and fact-based foundation around the advice financial planners provide to ultimately help clients meet their lifestyle goals.

Multi-dimensional financial modelling

In modelling, the traditional linear approach to this type of analysis often asks more questions than it answers. This leads to gaps that advisers fill through assumptions, rules of thumb and a host of other behavioural biases that are well documented.

Until recently, limited computation power meant that providing true asset liability and cash flow calculations was nigh impossible. Most financial planning software and excel spreadsheets, of what forms the basis of advice modelling in this industry, are linear, not multi-dimensional. In the age of algorithms, artificial intelligence and big data, there is a genuine opportunity to reduce the size of these gaps to create a more quality, meaningful and focused conversation between advisers and their clients.

Unsurprisingly, financial planning is a complex business, but at the heart lies a simple mathematical equation: assets and income need to meet an investors changing expenses over time.

This is known as **asset liability matching**, an intelligently designed strategy employed by large businesses and institutional investors for decades. This is the practice of projecting a series of lump sum cash amounts to be available at specific dates, at specific times, in the future. In particular looking at liquidity, (time/risk) income and future value. Example use cases include; funding retirement, setting aside funds for children's education, a planned home renovation or the purchase of an investment.

The intelligent design and power of a multi-dimensional modelling engine, one that can produce thousands of scenarios, economic stress tests, permutations and combinations of strategies, will evolve the industry into more interactive complex problem solving for clients, via optimisation and machine learning.

This modelling power behind the user experience will demonstrate to a client, in near real-time, their current circumstances, and how to bridge the gap from where they are now, to where they want to be in the future - aligned directly to the achievement of their financial goals. This interactive "what if" and "trade off" analysis can deliver an incredibly engaging financial advice experience, doing much of the grunt work of an adviser and paraplanner.

It sounds simple, but in reality it is incredibly complex.

Sophisticated financial modelling requires a unique and specialist skill set that has traditionally been the domain of institutional businesses and actuarial firms, we now see this skill set flow into financial planning technology.

This will further add to the confidence and trust in the analysis that forms the basis for advice in this industry, leading to a stronger adviser client relationship and ultimately improved socioeconomic outcomes available for more Australians.

Goal tolerance for investing

Goal tolerance in investing is different. Rather than looking backwards, it seeks to identify a client's future goals. By clarifying their priorities, time horizon and behavioural preference towards risk, goals based investing helps maximise a client's chances of success, using a more flexible portfolio design methodology.

The primary aim is always to maximise a client's chances of achieving their specific outcomes, whatever they happen to be.

In the traditional approach to asset allocation, an adviser would start by asking a client for their goals. They would then amalgamate these goals into a single wealth portfolio view based on their risk tolerance score; a questionnaire that determines their attitude towards risk - called Strategic Asset Allocation (SAA). This

asset allocation by definition is more backwards looking, it would have an expected return based on historical or expected performance benchmarks over a certain time-period.

As illustrated in the below asset allocation diagram, an example of a short-term goal would generally have less exposure to risk (eg: liquidity = cash) vs a longer-term goal that would accommodate more risk exposure (eg: growth = equities). Similarly, a person may tend to take on less risk for essential items, such as living expenses, and higher risk for more discretionary items like the purchase of a boat. Each goal not only has its own unique risk vs return, but we also must consider today vs tomorrow, and each client's individual expectations and preference.

Goals-Based Asset Allocation Chart

	Goal Tmeframe								
	0-2 Years			2-5 Years			5-7 Years		
Goal Priority	Essential	Lifestyle	Aspirational	Essential	Lifestyle	Aspirational	Essential	Lifestyle	Aspirational
Highly Conservative	Cash	Cash	Cash	Cash	Conservative	Conservative	Conservative	Balanced	Balanced
Conservative	Cash	Cash	Cash	Conservative	Conservative	Balanced	Conservative	Balanced	Growth
Moderately Conservative	Cash	Cash	Cash	Conservative	Conservative	Balanced	Conservative	Balanced	Growth
Moderate	Cash	Cash	Cash	Conservative	Conservative	Balanced	Conservative	Balanced	Growth
Moderately Aggressive	Cash	Cash	Cash	Conservative	Conservative	Balanced	Conservative	Balanced	Growth
Aggressive	Cash	Cash	Cash	Conservative	Conservative	Balanced	Conservative	Balanced	Growth
Highly Aggressive	Cash	Cash	Conservative	Conservative	Conservative	Growth	Balanced	Growth	High Growth

While the foundation of the industry is built on Harry Markowitzs Modern Portfolio Theory, many modern behavioural & financial economists see flaws in the current mathematical portfolio theory – as it assumes that people act rationally and make assumptions around their predisposed knowledge of financial markets. This theory is inaccurate, and we must take into consideration that what people think & feel today may be different to how they think & feel tomorrow – and that others may influence a person's decisions and biases at any given moment.

As goal achievement is more meaningful and personal to clients, rather than outperforming a market by a percentage or a benchmark, advisers can more accurately monitor a client's progress back to their goal achievement, and risk is evaluated by goal priority, probability and time horizon, alongside behaviour. Asset allocation becomes a more flexible and tailored approach for client portfolios.

Evolution

The evolutionary role of the Financial Adviser

Accountant, investment quant, life mentor, actuary, and sales negotiator. These are some of the roles that financial planners have traditionally had to assume in their work with clients. It's no surprise that increasing regulatory pressure has resulted in many seeking to leverage technology, to redefine their business models, so they can reassert their focus on client relationships and the softer skills necessary to manage them.

The rapid growth of FinTech, combined with consumer and regulatory change has resulted in the evolution of the adviser role. Data, machines and algorithms will soon outperform a lot of the calculator, research and administrative functions. The industry is undertaking an important step towards automation. These modern advancements will see the advisory role to focus on the client relationship, role as a financial life coach and relationship manager, improve financial literacy and improve financial outcomes for Australians.
Learn more about the new world of financial planning software.

Are you Goals Based Advice ready?