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What to expect from Goals Based Investing (GBI)

The idea that we should invest to meet our needs and goals is basic common sense. But, somewhat surprisingly, that is not what most of the investment industry does.

The current status quo is that investments are generally built around a reference to a 'benchmark' such as shares, property or fixed interest – and the many derivations thereof. Diversified portfolios are then built using Modern Portfolio Theory, based on the assumptions of the Efficient Market Hypothesis, to create an 'optimal' Strategic Asset Allocation (SAA) to match a Risk Profile. Your stated risk profile then determines your investments allocation.

Lots of good theory, if all the assumptions hold and everything is readily predicable, but unfortunately, life in the real world doesn't always work that way. Markets are not always efficient and predictable. Past behaviour is not necessarily reflective of future behaviour, etc…

Then there is a question about whether the idea that how someone 'feels' about their investments will perfectly match what they 'need' to achieve their stated goals. In practice, they almost never match up. Whilst it's obviously important to understand and respect someone's risk tolerance, the reality is, using a risk profile or SAA approach to design portfolios is almost guaranteed NOT to meet your needs.

Goals Based Investing is a simple, rational approach to building portfolios that specifically targets meeting known needs - so long as they are reasonable of course. It's far more intuitive to understand why you are making an investment, which helps overcome a raft of behavioural finance issues as well as help address technical strategic challenges such as sequencing risk and income / cash flows planning in retirement. It can be used to enhance the application of Modern Portfolio Theory, in the real world.

While the **WHY** can be readily understood, there are some fundamental differences in **HOW** Goals Based Investing is different from traditional SAA investing. Typically, the main differences are;

- There are much broader asset allocation ranges, allowing a GBI manager greater flexibility in what asset classes and investments they can invest into,
- GBI portfolios generally have a greater ability to allocate to alternative asset classes or investment strategies such as equity long/short, infrastructure, commodities (soft and hard), CTA and global macro.
- To try to meet objectives through a cycle, GBI managers will use Dynamic Asset Allocation (DAA) to invest only into assets they believe will meet their objectives, at a particular point in time,
- There is a much greater focus on risk (volatility) of asset classes given the more defined investment objectives of GBI investments. The aim is to limit the extent and severity of loss of capital value. As a result, GBI portfolios exhibit a strong focus on capital protection.
- GBI portfolios generally do not benchmark against traditional markets, such as shares and property, which can be volatile and have little relevance to the outcomes required by investors.

Due to these differences, the skillset required to build and manage a Goals Based Investment portfolio is different to traditional managers. In fact, given the history and current status quo of investment managers, it's not that easy to identify high quality 'true to label' Goals Based Investment managers. There are some managers that hold themselves up to Goals Based Investment managers, but in reality, that may be more marketing than substance. Care should be taken when identifying a Goals Based Investment solution that you believe suits your needs.

If you are interested in Goals Based Investing, because it makes good sense, it's important to understand what to expect from Goals Based Investing. With a different approach comes different outcomes.

Firstly, it's important to understand what NOT to expect from Goals Based Investing. Just because you 'target' an outcome it doesn't mean that it is 'guaranteed'. All investment involves risk regardless of how you do it. You will still experience volatility of your capital. Your investments will still go up – and down. Results will not be achieved in a straight-line month after month. The 'target' is that the result will be achieved over the stated investment timeframe, be it short or long-term.

There are however certain attributes that you CAN expect from Goals Based investing.

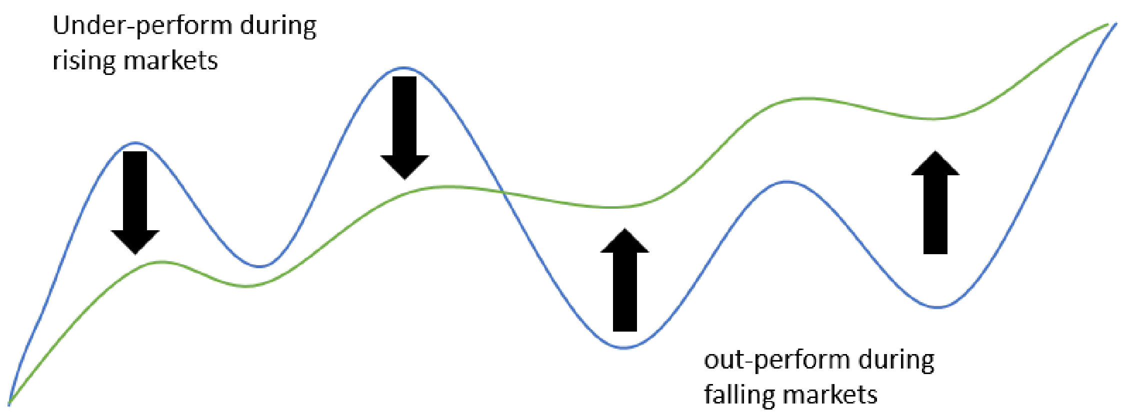
Primary amongst these is that if you are targeting specific outcomes, and managing diligently to that purpose, then you should expect a higher probability achieving that outcome than an approach like SAA may deliver at any particular point in time. If it improves the likelihood of you achieving your goals, then that in itself is a good thing as it can help provide some peace of mind.

You should expect less volatility and a greater degree of capital protection.

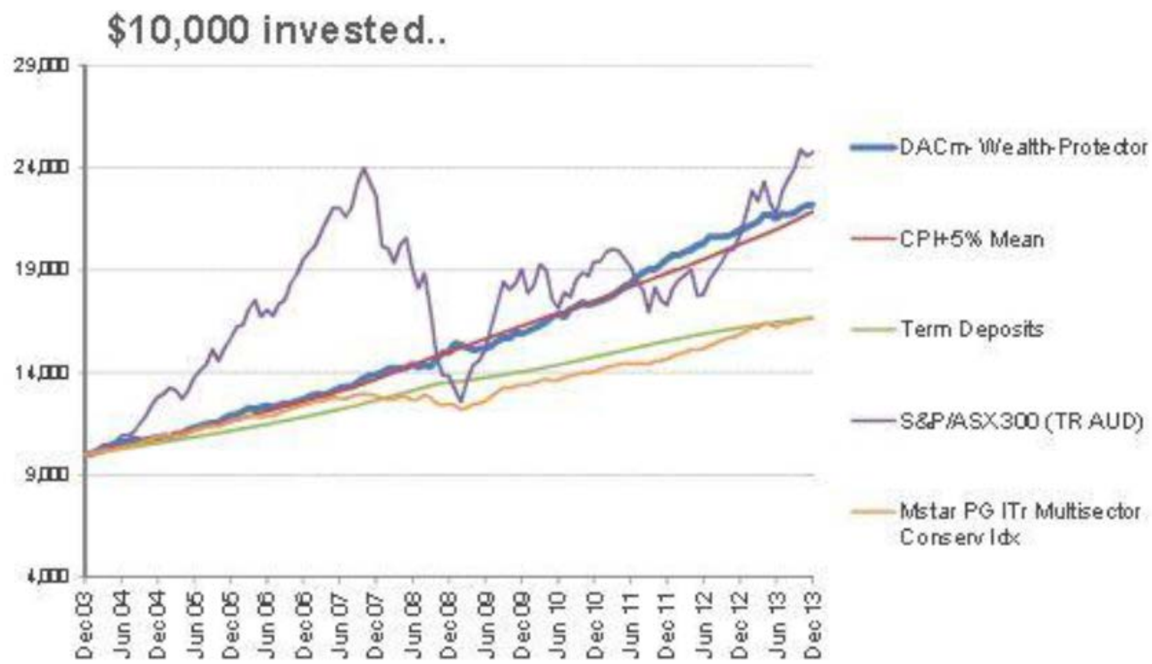
These are two very important points to bear in mind. Numerous surveys point to the fact that the top priorities for investors are: (1) peace of mind and (2) protection of capital. Investment returns actually come in 4th on the list of priorities.

Finally, if you invest into a diversified Goals Based Investment portfolio will not behave like traditional markets or benchmarks. Market outcomes become irrelevant as they are likely to have little to do with the targeted outcome. For example, if you have a CPI + 5% target return, then does it matter what the share market does?

Combining these factors together, simply put, you should expect a Goals Based Investment with lower volatility would under-perform during a rising market and that it will out-perform during a falling market.



To illustrate the point over a market cycle, we use a modelled example of the Wealth Protector portfolio from [Dynamic Asset Consulting](#) (DAC), a Goals Based Investment manager. It shows that using a Goals Based Investing approach it achieved its CPI + 5% target between 2003 and 2013, including the period through the GFC. Interestingly you can see the wild swings in the share market had little effect on the DAC portfolio and investors were subject to much less volatility, but, in the end the result was much the same. If you're looking for peace of mind and security of capital, the smoother ride is likely to be the preferred outcome.



Not surprisingly, Goals Based Investing is gaining understanding and acceptance among financial planners and retail investors. The reasons are obvious and simple; it makes sense, provides more reliable outcomes and can be more easily applied to specific investor goals and circumstances.

The Association of Goals Based Advice (AGBA) is working diligently to help financial planners, and others associated with the financial advisory and investment markets, to provide best practice thought leadership and tools for goals based advisers and investors.

Goals Based Investment managers, such as Dynamic Asset Consulting, have built and are managing 'true to label' Goals Based Investment portfolios, which are available to retail investors and financial planning firms.

To understand more of and how Goals Based Investing may suit you, search for a good Goals Based Adviser, who you can work with to achieve your goals and peace of mind.