Planning and Common Language: Keys to Retiree Confidence*

By Wayne von Borstel

Wayne von Borstel discusses the planning problems that can arise when financial advisors and their clients do not understand financial terms in the same way.

Retirees whose portfolios have been the most adversely affected in recent months may think we are experiencing a singular financial meltdown, but while the current economy suffers from a serious malaise, it is not inoperable and the patient should recover. Nonetheless, things are plenty bad. The fear and uncertainty over the future is palpable, but retirees' portfolios have suffered significantly.

Recently, we were riding the second-longest market rally in history. It had to come to an end. We knew that or should have known it. What no one knew was what would trigger the downslide or how fast or how far it would go. Any rational person recognized that, eventually, something was going to happen to cause the market to reverse itself.

Whatever economic policies the new Administration and Congress decide to pursue, ultimately, the markets will recover. A lot of investors mistakenly assumed that "free markets" meant values would climb endlessly. They have now learned the fallacy of that assumption. What makes us a great country is that free markets permit investors to be smart, or stupid, about what they do and reward smart investors over the long term.

Investment advisors play an important role in how retirees, who are dependent upon their portfolios for their livelihoods, react to market fluctuations. An informed reaction will require swimming against the tide of the alarmist mass media. It requires going against the widespread miscommunications that currently exist between retirees and the financial community that serves them. It also requires swimming against the rampant fixation with investment performance as opposed to prudent planning which is systematic, unemotional, and diversified.

Let us consider each of these issues. I believe the most significant issue is that of communications—the greatest impediment of which is lack of a common language.

What Language Are We Speaking?

I frequently speak at financial events and have the opportunity to chat with audience members afterward. Rarely do I find investors who can accurately define their investment strategy. The attendees might say they are "conservative" or "moderately aggressive" or "opportunistic." Their descriptions usually mimic the terminology used by the advisors who created the investment portfolios. Most of the time, however, the investors do not have a clue as to what the terminology means. I do not mean to say they are stupid; they usually think they know what they mean. Rarely do their portfolio compositions reflect their portfolio descriptions. Often, the two are not even close.

Let me illustrate the communication problems with a real-life example. The longtime advisor to an 85-year-old woman died. His son took over the business, but the elderly client was not comfortable with the young fellow, and expressed those feelings to her

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son. On the recommendation of one of my clients, the son brought her to see me.

The elderly lady sat down and immediately went into a lengthy oration. She spoke of how conservative she was, and how the deceased advisor had always been such a good listener, and so attentive in making sure her portfolio reflected her extremely cautious investment philosophy. I sat silently and listened as she talked of not wanting to take any risks with her investment capital. At about the 30-minute mark, I made a mental note that risk taking was a dead issue. She would never let me do anything different or suggest any new opportunities, no matter how risk averse they might be.

Finally, I asked to see her portfolio. It was 95 percent individual stocks! Someone told her that was a conservative approach and she believed it. Obviously, not only was she not speaking the same language as her former advisor, there was a lack of prudence as well. Individuals who invested 95 percent in stock through their 401(k) plans now call them "201(k)" plans because the market decline has been around 50 percent.

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It took some time, and several meetings, before the lady would accept that her portfolio was far too volatile, given her cautious demeanor. Thankfully, her son and I were able to convince her to restructure it, dramatically reducing the portfolio's equity allocation. It was really difficult for her to accept that she, and the advisor she liked so much, had been on a totally different page regarding her investment strategy.

While she did not say, I think she continued to have misgivings about the revised asset allocation, even up to the time the markets tanked. She would have lost a major portion of her portfolio, had we not made the changes. Now we are pals.

In another case, I manage the retirement portfolio of a retiree who had a successful practice as a financial advisor. I have more problems discussing terms with him than I do with my ordinary clients. He is very knowledgeable, and knows what he means, but we often use different terminology or have different definitions for the same terms.

If you asked a dozen financial advisors what "moderately aggressive" means to them, you would get dissimilar meanings. There is simply no common language among investment advisors. What is conservative to one person may be aggressive to another person.

Every experienced financial advisor has encountered similar situations at one time or another. We scratch our heads and wonder what the other advisor was thinking. Stuffing an 85-year-old widow's portfolio with individual stocks is, no doubt, an extreme example. Furthermore, it clearly involves something more disturbing than just poor communication. In most cases, miscommunication (or lack of a common language) is the reason portfolios are not aligned appropriately with investors' objectives. Investors and financial advisors may be using the same terms, but they either have a different understanding of what those terms mean, or the advisors are making assumptions instead of probing more deeply to make certain the terms are understood.

Since there is no common language, it is up to financial advisors to take the lead and make sure each client understands the language we are using. It is largely a matter of mutual interpretation.

My wife was born in Chile. When we vacation there, I have precious little idea what the locals are talking about. I have learned a few words but I have no in-depth or accurate understanding of the Chilean language. Fortunately, my wife does and so we get along fine. In a way, it is the same for most people when they talk to their advisors. They pick up some words and phrases, here and there, but one side may as well be speaking Spanish.

If we have established a relationship of trust, our clients tend to believe what we recommend is right for them. Do they really understand what we are saying? Do we really understand what they mean? Are they sufficiently comfortable with the relationship that, when necessary, they can express they do not understand what we are saying or doing?

I believe our responsibility is to help make them as knowledgeable and familiar with our language as possible. It will take more time, and if they are not accustomed to more detail, I suspect some of our clients will even resist our efforts. If we make them more knowledgeable, when times get as bad as they are right now, clients can believe in, and fall back on, the

strategies developed in the planning processes. That is what helps give them confidence in hard times and that is what will help keep them on board as clients. They have to be fully invested in what we are doing for them (excuse the pun), why we are doing it, the levels of risk involved and how our plans will function, in good times and bad. All this has to be expressed and understood in a common language. If not, the relationships will not work. When people speak, and cannot understand each other because they are speaking different languages, they tend to start shouting at one another. Miscommunication and misunderstanding are the source of most of the world's problems.

The Perfect Financial Storm

At any time, a confluence of just three events can subject an individual to the perfect financial storm: a significant market drop, double-digit inflation and failing health. Over the past 50 years, the markets have suffered above average losses on thirteen occasions. In other words, above average market losses seem to happen about once every four years. Thus, retirees who have a life expectancy of 30 years are likely to experience another six or seven major market slides. Combine one of these drops with high inflation and someone's failing health and, barring detailed planning, you have a recipe for financial disaster.

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Of course, when market losses will actually occur is unpredictable. Markets, however, are not always going to rise. Inflation is not always going to be low. One's health will not always be good. Without adequate preparation, our clients may not survive financially; with it, potential disasters are more likely to become almost non-events.

We have to instill focus and confidence in the planning process. Portfolios may go down, but with a good plan, they should not go down as much as the broad markets, and certainly not enough to force lifestyle changes or trigger panics. The biggest enemy in times like these is being forced to spend investment capital. Retirees must have a plan in place for times like these. Typically, a plan should include six months of emergency funds, five years worth of conservative assets, a budget that allows them to live comfortably on three percent of their wealth annually and no debt. When times are good, many investors ignore these guidelines, but the price they pay when things go bad is a loss of financial confidence, and that may be an irretrievable loss.

Current events have proven to me that all the work financial advisors did in the past to alert clients that the party would eventually end was the right thing to do. Even though some resisted our efforts, and did not want to hear it when the markets were soaring, sounding an alarm was justified.

Generally speaking, I think there are two opposing positions within the financial services industry. The majority position believes in utilizing analysis, software or some other system to determine which stocks, industries or sectors are going to outperform others. Client portfolios are then structured to match those evaluations. If something goes wrong, a new answer is developed and tried. Of course, that is not a solution, but it does help clients feel better when they take a hit. It also keeps them searching for the eternally elusive secret to performance. The alternative (and less popular) position is to stress the planning process, press clients to participate, anticipate what might happen if the screws come loose on the markets and be prepared. I am a believer in the latter approach.

Our industry, in collaboration with the mass media, has created the illusion that at any given time someone has "the secret" and is wiling to share it with investors. Someone can tell them where the jigsaw puzzle's final piece is before the first piece is put in place. Someone has the "ultimate" secret. When I read what I just wrote, it sounds rather humorous. What is not funny is how many otherwise intelligent people buy into this fantasy, in some iteration or another, every day.

In trying to do the right thing for our retiree clients, we can manage only four things: risk, cost, taxes and predictable return. That is it. So, logically, that is where our focus should be. We need a plan so that when things go wrong, our clients can expect to survive.

Never Too Late

It is almost never too late for good planning. Investing does not end when we retire, that is only halftime in the game. We still have to play the second half. While we are working, we are investing for retirement. After we retire, we invest for ourselves and to maintain our lifestyle. Once we reach our mid-seventies and older, we are typically no longer worried about ourselves as much as we worry about what to leave our heirs or to charities. The game becomes one of how to preserve wealth for our family and our last wishes.

We have to remember that there is another team playing against us, a team made up of inflation, taxation, occasional bad markets and, eventually, declining health. That team takes the field and plays whether we do or not. If we do not show up for the second half, we lose by forfeit. We have to show up and play. To do that effectively, we need a coach to create a reliable game plan, regardless of whether it was drawn up at the beginning of the season or at halftime. We all know even good coaches have to make "game-time" adjustments, but those are made once we know how our opponent is trying to defeat us, and are typically minor tweaks to an already solid plan.

Much of the responsibility continues to fall upon financial advisors. The mass media likes to hype the "investment strategy du jour" at the expense of planning because that is a juicier topic. In addition, it is apparent that the primary goal of most financial broadcast programs is to keep viewers nervous, and fearful, so they continue to trade and continue to tune in for the next "insight."

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As advisors, I think we have to take the lead in changing public perception. Which is more important: planning or management? We have to try to help calm investors' fears. We need to guide them toward becoming confident as the result of having solid (but flexible) financial plans they can fall back on in good times and bad. The broadcast media's role is to keep investors agitated so they keep listening and buying sponsors' products. As advisors, we need to counteract this financial hypocrisy with candor, clarity and communication, which requires a common language.

Today's markets illustrate the value and importance of planning. Most investors who thought they had a plan now realize they do not. Their brokers have stopped calling them or, if they do call, it is to beg them to "stay the course" or some similar bromide. What value does that advice hold when retirees are spending out of a down market?

Sometimes clients have been left to fend for themselves, while mulling their decisions to chase investment returns without a formal planning process. Investors who had a good coach, who prepared them for the volatility and market chaos that is currently going on, are likely doing better but they tend to be the exception. Retirees who placed greater value on performance than planning do not know what to do or where to go now to generate sufficient income.

A herd mentality has taken over and people will do anything they see others doing because they no longer trust their own judgment. The reason they lack faith is because they have no basis, no plan, on which to fall back.

When people are euphoric about soaring markets and real estate values, the importance of planning tends to be minimized. The notion of an eternally rising economy mesmerizes investors into ignoring the lessons of history. They concentrate their holdings into what they perceive are "hot" segments and ignore the need for diversified portfolios.

During the historic market run-up over the past few years, many of us continued to stress the importance of having a sound plan in place to help compensate for an inevitable downturn. Not all of our clients listened. For those who did, many are weathering the storm without suffering irreparable damage to their financial ships. That is not to say they have not experienced angst or losses, but it is one thing to be down 20–30 percent in a market down 50 percent; it is quite another to be down 90 percent. For a retiree with significantly eroded investment capital, this kind of loss is debilitating, since it can no longer generate adequate income. Just as bad, a senior may lack the time to recover or the ability to return to the workforce.

Recently, several people who are not clients of mine approached me after church services, lamenting how they have lost 90–95 percent of their retirement portfolios, typically because they were invested primarily in a single stock or fund. Each of them thought they understood what they (or their advisors) were doing. None believed they were taking extraordinary risks. None thought they could suffer an almost complete erosion of their investment capital. It was heartbreaking to hear their stories.

Amidst all this carnage, the mass media shamelessly continues to drag out the same Wall Street "talking heads" who helped prolong the grand illusion by hyping stocks held in their trading-desk accounts. Of course, now these experts are offering "disaster advice"

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for the huddled masses who are yearning for a safe haven. The underlying, and unspoken truth, is that these firms are often heavy advertisers who sell financial products and services and make money only when investors trade, not when they sit on the sidelines.

Preemptive Financial Coaching

Preemptive coaching can be as effective for retirees as it is for athletes. Why does Tiger Woods, the greatest golfer in history, continue to spend money for the advice of a coach who cannot hit the ball nearly as well as Tiger, himself? Because Tiger does not know when his swing will get out of tempo or when he will get into a bad habit. Tiger realizes he needs someone watching to help him get back on track when something goes wrong. Just like great athletes, we get the most potential with a concerned coach and a good plan.

Obviously, there is no single "grand plan." Each person has a unique set of circumstances, preferences, time horizon, risk tolerance, lifestyle requirements, late-life wishes and other factors. No one knows when the next event will occur that will rattle the markets to their foundations. It may be an act of terrorism, political lunacy, a financial meltdown, a scandal or an assassination. Whatever it is, we know something will occur that will jolt the markets and cause the next downward spiral. Whatever it is, whenever it occurs, however long it lasts or how bad it gets, it will happen sometime in the not too distant future. Without a good coach and a good plan, many investors will no doubt overreact, and do something ill advised that will cost them dearly.

As financial advisors, we should shun relationships with those who resist coaching or insist on a relationship based solely on investment performance. Those are auditions not relationships. Our mission as advisors should be to help investors, and in particular, retirees, avert potentially disastrous outcomes. We can accomplish this by crafting plans that will help them maintain their equilibriums so they can continue to make good decisions—even when the bad times inevitably occur, and reoccur.

Saving Them from Themselves

When the going gets rough, frightened retirees call their advisors. All want reassurance; some want to do dumb things, fast. I believe that when clients call in response to market volatility and tell us they want to do this or that, we need a plan that they can refer back to. A plan we created together. A plan they have looked at a dozen times and with which they have grown comfortable. That way, we can calmly discuss what has really happened, what they are feeling, and what reality is versus a perception fomented by what the media or friends are saying.

We can go through the numbers and show them where they are, based on the goals they set. Having that available in times of turmoil is invaluable because no matter how agitated or fearful they feel at the moment, if we have done a thorough job of planning, and speak the same language, it is likely they will still be on target toward meeting their goals. Just as importantly, they will be able to cope with the inevitable setbacks. The plans crafted for them will be solid and they will understand those plans. Their investment strategies will mirror their goals, and they will be able to cope with any passing economic storm, typically with only minor adjustments.

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Endnotes

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