Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

In this section we will review personal and family objectives as means of attaining goals. Also included in this section is a discussion of the need for contingency planning, development of the overall plan as a natural evolution of the objective setting process, lifetime planning, and planning for dispositions at death.

# Identification of Personal and Family Objectives

The single greatest skill a financial planner should develop is the ability to understand people and how to communicate. Communication is complicated by the fact people are complex and often don't want to reveal their attitudes and values. People are threatened when someone else knows too much about them. Money matters are very personal. It can safely be said that "a man's worth to society is measured not by how much money he had, rather by how he spent it." Though specific objectives are unique, it is helpful to review some that are common.

Providing For Necessities

Though degrees obviously vary, everyone has a need for current consumption. Most individuals raise their standard of living to fit their income. Psychologists tell us that people first attempt to satisfy physical needs. The first priority is to generate sufficient funds to provide necessities for one's family. After food, clothing, and shelter are acquired in sufficient quantities, higher level needs are approached.

Affection, friendship, camaraderie are a few of the many forms of human interaction. Unless it is absolutely necessary for survival, few individuals want a solitary existence. Instead, they want to interact with others. They want to identify with a group. They want other people "to like" them. Personnel specialists have found that many employees value positive, friendly human interaction as much or more than incremental remuneration.

As the need for belonging and love is satisfied, individuals seek status. Advertising agencies try to create brand recognition with status in order to sell the products produced by their clients.

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

"Self‑actualization" is the objective of realizing one's own potential. A wealthy individual may spend time away from work to build a cabin in the woods. The cabin represents much more than shelter. It is the outward expression of this individual's need to create something of value and substance using hidden talents: the individual's objective of self‑actualization.

The pursuit of these objectives generally requires money (or time away from financially rewarding work). These goals may be for oneself, members of one's family, business, favorite charity, or virtually any other person or organization of interest to him or her.

Such goals also may vary in countless other ways. For example:

1. they may be large or small;

2. they may call for specific amounts or indefinite amounts;

3. they may contemplate attainment; immediately; on a specific future date; at any future time on demand; at death of the investor or of someone in whom he or she is financially interested, or at some indefinite time in the future, and

4. they may call for cash in one sum or in installments. If installments, they may be periodic or irregular (as on demand), of equal or variable amounts, and to continue for a specific period (including for life) or for an indefinite period.

Moreover, the goals may vary in degree of importance to the individual. They may vary from absolute necessities to desirable "luxuries." For our purposes, an individual's necessities are basic objectives, and all others are collateral objectives.

Need satisfaction is important in identifying the individual's key objectives. Although there is a tendency to approach needs in sequence, this isn't completely true. One individual may need a great deal of safety before he or she tries to find love or friendship. Another may attempt to satisfy "higher order" needs while lower level needs are only partly satisfied or are ignored completely. Some individuals may never realize that higher level needs exist because their efforts are almost entirely directed toward satisfying basic physical and security needs.

The individual's needs are, of course, personal. It requires a psychologist to evaluate the influences that have collectively caused the person to have the needs, emotions, and objectives that he or she has. It is, however, important financially for the planner to help the client list and prioritize, by degree of importance, his or her objectives. Even though certain needs are currently being satisfied, these should also be covered by the

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

plan (so they can continue to be satisfied). Priority should be given to those needs and objectives, which yield the greatest satisfaction. Basic objectives can then receive appropriate attention. Then, after these have been satisfied, collateral objectives can be addressed.

Objectives, whether basic or collateral, can be divided into two broad categories: (1) fixed amount objectives; and (2) variable amount objectives. They usually stem from differing motives and situations, but are complementary parts of the well‑organized financial plan since the family is an economic unit with limited financial resources to allocate in such a manner so as to maximize total satisfaction. "Satisfaction" is obtained when objectives are met.

Social Objectives vs. Personal "Greed"

The financial planner must deal with social and moral issues objectively. There need not be an inherent conflict between personal "greed" and social objectives.

Projection of time/needs: The nearer in time an objective or need is, the higher the stress it causes.

Procrastination for purposes of the discussion is the process by which people spend money today and try not to worry about the needs of the future.

A financial plan, to be effective, must recognize future objectives as well as current objectives. Just because it is hard to quantify these distant goals is no reason to ignore them.

Retirement is an event most young people rarely consider. By middle age many people view retirement as a welcome future opportunity to do what one enjoys, without time constraints. By actual retirement the individual may have emotional fears about leaving the security of employment, especially if retirement funds are insufficient to maintain the current standard of living.

Can the individual physically and mentally work until death? Does the client's employer have a mandatory retirement policy? Is a hobby interest able to generate some income? If the client does want to retire, when is the right time? How much additional income is needed, after reduced living expenses, lower taxes, the employer sponsored pension benefits, and Social Security is considered?

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

Death is the conclusion of one's personal financial plan. This event will happen with certainty but may be much sooner or much later than expected. For example, the individual might die a short time before the elaborate retirement benefits would have commenced. Death is really not a separate event to be planned for. Rather, it is a contingency only as to timing that must be taken into account with other plans. A typical retirement plan has pre‑retirement death provisions.

Death objectives are those which must be met at the time of death or sometime thereafter. Some of these needs will be created by death itself. Others will arise or continue to exist because someone else lives on.

A major consideration, of course, is that death generally ends the building of an estate —and no one knows how much estate‑building time exists. Whenever death occurs, the estate that is already accumulated generally is all that is available to satisfy the death objectives. Whether or not that estate will be adequate is a critical question in the planning process.

Projection of Future Economic, Political and Tax Policies

It is impossible to measure objectives in static terms. When the planner asks the individual to outline financial objectives, it is well to remember that the response, in general, is based on past and present conditions. These may or may not provide a solid fundamental basis for the establishment of future objectives in light of anticipated change. The selection of specific financial resource strategies and even valuation of existing assets to some extent is dependent on the individual's perception of future conditions just as current market value attempts to discount future events by anticipating them and adjusting prices accordingly. The more uncertainty that is built into any forecast, and the higher the opportunity costs, the more severe will be the discount rate. After establishing general objectives, the financial planner must then help the individual measure future contingencies as they affect these objectives.

Economic projections can begin with fairly simple appraisals. In general, an attempt is being made to measure the individual's financial future in relationship to the broader economic and social structure. A few examples may be helpful:

1. Is salary and earning ability likely to increase? Have career objectives been established?

2. Will the standard of living increase?

3. Are shortages of physical resources or labor inputs likely?

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

4. Are future business conditions likely to be favorable (e.g., profit margins and the rate of return on owners' equity)?

What demographic changes or shifts in preferences can be anticipated? Political projections are speculative, at best. However, it has been demonstrated that political activities are a major determinant of both long and short term economic changes. For example:

1. Is the "Fed" expanding or contracting the money supply? Is the economy in a recession? Are interest rates rising or falling? Is the government (including state, local, and federal) operating in a deficit or surplus? Based on these considerations and others, what short term inflation rate is likely?

2. When is the next major political election? What major fiscal and monetary policy changes are possible in anticipation of the election or as a result of the election? Are there major undercurrents of long-range change in voter sympathy?

3. Will major legislation change the availability or amount of Social Security and other government provided benefits?

It is helpful to attempt to project future tax environments, because those taxes will largely determine the ultimate amount of lifetime disposable income. Examples of questions that should be considered include:

1. What changes in itemized deductions might take place? Will existing "loopholes" be retained?

2. Are income tax incentives with expiration dates likely to be extended?

3. Are income tax rates likely to increase or decrease?

4. If retirement includes potential relocation, which states (or countries) offer the most favorable tax structure?

5. Are established trusts flexible enough to absorb tax changes?

Change is inevitable. Those that successfully anticipate change can actually profit from negative events, economic downturns, and political changes. Those plans that include flexibility and contingency strategies may survive reasonably intact, despite otherwise adverse circumstances.

Refined Objectives

First, the client establishes general objectives. These are necessary to set priorities for the planning process. Second, the financial planner jointly discusses the future with the.

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

client, in a personal application of general economic, political, tax, and social assumptions. This is not an easy task The client will need to incorporate assumptions covering the future into refined objectives in four critical areas

1. lifetime family and dependent responsibilities, and obligations to others;

2. personal retirement security;

3. business commitments and ownership; and

4. estate planning.

# Investment Objectives

Underlying most client objectives and goals is the need for an effective plan for putting investment dollars to work in order that future goals can be accomplished. Although no magic formula exists, the following three step procedure can be successfully utilized by the professional financial planner in assisting his or her clients with both goal setting and the attainment of those goals:

* Step 1: Identify investment objectives of the client;
* Step 2: Select the type of investment, which will best achieve those objectives and the specific securities within the proper type of investment;
* Step 3: Select the proper time to buy or sell securities.

# Step 1: Investment Objectives Of Clients

Step 1 of our four part procedure is to identify investment objectives. Investment objectives mean the personal cash, income and capital growth that clients seek to achieve solely with the properties they own or are thinking of acquiring. These goals may be for the investors themselves, members of their families, their businesses, their favorite charities, or virtually any other persons or organizations of interest to them.

These goals my vary in countless other ways. For example:

* they may be large or small;
* they may call for specific amounts or indefinite amounts;

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

* they may contemplate attainment
* immediately;
* on a specific future date;
* at any future time on demand;
* at death of the investors for those in whom they are financially interested;
* at some indefinite time in the future;
* they may call for cash in one sum or in installments that may
* be periodic or irregular (as on demand);
* be of equal or variable amounts;
* continue for a specific period (including for life), or for an indefinite period.

Moreover, the goals may vary in degree of importance. They may vary from absolute "musts" to desirable "luxuries." For our purposes, clients' "musts" are their basic objectives, and all others are their collateral objectives. Naturally, priority should be given to satisfaction of their objectives in descending order of importance to them —first, with respect to their basic objectives and, then, after those have been satisfied, to their collateral objectives.

Whether basic or collateral, objectives may be divided into two broad categories: fixed amount objectives and variable amount objectives. These objectives usually stem from differing motives and situations, but are complementary parts of the client's total goal in the well organized investment program.

Fixed Amount Objectives

Fixed amount objectives are those which call for the availability of specific dollar amounts of cash, or specific dollar amounts of income throughout specific periods, at certain times, or under certain conditions.

Normally, the motives behind these objectives are desires to:

* satisfy fixed dollar obligations;

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

* provide sure, definite dollar amounts of cash or income that are sufficient to cover at least the minimum needs of clients, their families, or their businesses;
* hedge against deflation by establishing a specific dollar floor below which the cash or income value of their portfolios cannot fall, even in the event of a depressed economy.

These fixed amount objectives may stem from either the possibility of death or the probability of living.

Objectives at Death

These are objectives which must be met at the time of death or sometime thereafter. Some of these needs will be created by death itself. Others will arise, or continue to exist, because someone else lives on.

A major consideration, of course, is that death ends the building of an investment program —and no one knows how much time remains before death will come. Whenever it comes, the investments already accumulated are generally all that will be available to satisfy one's objectives. Whether or not those investments are adequate is often a moot question.

There is an important exception: life insurance. At death, life insurance creates an immediate estate of any desired specific‑dollar amount. In almost every case, that amount will be substantially more than the total premiums paid for the insurance plus a fair return on money. That is a major reason for including life insurance in a client's financial program. It creates at death more dollars than many can accumulate in a lifetime.

In addition, the life insurance proceeds may be distributed on a guaranteed, specific‑dollar basis in virtually any desired manner. They may be paid in a lump sum or in regular income payments throughout any specified period, including the remaining lifetime of the recipient. Where estate taxes are a factor life insurance policy proceeds can be sheltered from estate taxes through utilization of an irrevocable life insurance trust.

Investment properties may satisfy or help satisfy some objectives at death to the extent they are acquired before death. But only life insurance creates an estate at death, guarantees the specific amount of that estate, and assures the desired distribution of that estate. Thus, through life insurance alone, a death estate equal to virtually any

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

property to satisfy objectives at death, life insurance has no peer.objective at death may be created ‑ and on a guaranteed, specific‑dollar basis. As Typical objectives, which call for immediate or subsequent satisfaction in the event of death include:

* cash to cover costs of dying (final expenses, mortgage redemption and other personal or business debts, and estate settlement costs, including death taxes);
* cash to cover emergency needs (of the family or business);
* cash or income for children's educations (enough to provide at least minimum educational requirements);
* income for the family (at least equal to the family' s minimum needs —normally starting at death, continuing through the children's dependency period and thereafter, often in reduced amount, to the surviving spouse for life).

Living Objectives

Fixed amount living objectives are those, which, while life continues, call for satisfaction of needs or desires with specific dollar amounts of cash or income.

Since these objectives assume continued life, investors presumably have from now until the needs arise to build the investments that will satisfy those needs. Given the time available, clients may determine the rate at which they must accumulate the property required, and can schedule their investing accordingly. Naturally, the property used for this purpose should assure the specific‑dollar cash or income required, and the time needed to satisfy the particular fixed‑amount objectives of the investors.

Here are some typical fixed amount living objectives (several are common to virtually everyone):

* cash to cover emergency needs (of self, family or business);
* cash to complete future goals (personal or business acquisitions, projects, etc.);
* cash or income for children's educations (enough to provide at least minimum educational requirements); income in retirement (enough to provide at least minimum needs after retirement —normally for self and spouse, and guaranteed to continue monthly for as long as both live, then for as long as the survivor lives);

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

* cash or income to hedge against inflation (of assured fixed‑dollar amounts —whatever the investors believe are necessary to prevent the total value of their investments from ever falling below certain minimum dollar levels in event of a general economic decline).

Note the great similarity between fixed amount living objectives and objectives at death. But keep this important distinction in mind: attainment of living objectives assumes that clients will live until the specific needs arise. Attainment of objectives at death, of course, cannot include this assumption.

Variable Amount Objectives

Variable amount objectives are those which call for cash or income dollars in whatever varying amounts are required to keep pace with the economy in satisfying certain needs or desires when they arise or while they continue.

Like fixed amount objectives, variable amount objectives may be either living objectives or objectives at death, depending upon whether they call for satisfaction during the client's lifetime or after they are gone. Actually, there is very little difference in basic purpose between most variable amount and fixed amount objectives. Both seek satisfaction of much the same needs and desires. The only real difference lies in how satisfaction of those needs and desires may be best attained. This similarity is apparent in the following examples of some typical variable amount objectives:

* cash for emergencies or to complete future projects and goals (in dollar amounts which will vary to keep pace with the economy);
* cash or income for children's educations (in dollar amounts which will vary to meet college costs, especially increases in college costs, when the children are ready for college);
* income in retirement (in dollar amounts which will vary as necessary to maintain a relatively constant level of purchasing power, whether the cost of living is up or down);
* cash or income to hedge against inflation (in dollar amounts which will vary with the economy, to offset the possible decline in value of fixed dollar holdings in the event that the dollar continues to depreciate in value);

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

* opportunity for more rapid than average appreciation (in personal affluence and wealth by sharing not only in general economic growth, but also in above average individual business growth on a selective basis).

As can be seen, variable objectives are usually motivated by such desires which lead investors to:

* enjoy appreciation in dollar values and share in true economic growth in keeping with general economic trends;
* build or expand personal affluence and wealth as rapidly as possible, commensurate with acceptable risk;
* provide a layer of cash or income which will maintain a relatively constant level of purchasing power, regardless of changing values of the dollar;
* hedge against inflation by establishing investments which will rise either in cash or income dollar value with (and thus offset) any further decline in the value of the dollar.

It is in the variable amount objectives area of the financial plan that variable life, variable annuities and mutual funds may, and often do, serve exceptionally well. When properly selected for this purpose, they provide the ideal complement of other fixed‑dollar properties in the well rounded, soundly planned investment portfolio.

Safety of Principal

The objectives generally most sought after can be identified as:

* current income and stable capital;
* growth of invested capital;
* current income with growth.

Depending on the clients involved, each of these objectives is tied to another important objective: safety of principal. The ideal investment is one that offers maximum safety of principal, high current income, and a high degree of capital appreciation. Unfortunately, such investments are difficult, if not impossible to find. Most offer a preponderance of one feature and a limited amount — or even lack of the others. Because of this, an axiom that is commonly quoted in investment circles is:

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

"The greater the safety, the lower the income and the smaller the growth; conversely, the greater the risk (or lack of safety), the higher the income and/or the greater the capital appreciation."

Only by trying to understand the human side of investment counseling can you hope to be of maximum use to the people with whom you deal. Only then can you properly comprehend that investment objectives and plans that seem entirely logical to you may be entirely unacceptable to others.

The Client

Many factors enter into the investment objectives sought by typical clients. However, one that must be recognized at the outset is the nature of the individuals with whom you deal.

All of us have certain ranges of tolerances within which we feel comfortable. These relate to heat, cold, emotional stress, etc. For example, in any meeting, you will find some people who are complaining of the heat, others who are complaining of the lack of heat, and still others who are perfectly comfortable.

It's exactly the same with financial plans. There is a comfort zone for every client. It is your job as a financial planner to match the individual tolerances of those with whom you deal with their financial needs and goals. For example, are they by nature gamblers, speculators, or investors? How can you answer this question? You can do so primarily by determining their respective attitudes toward safety, income and growth, as well as how they arrive at their decisions to buy, hold, or sell any investments they make.

Gamblers dream of fantastic growth in a hurry. They play hunches or take chances without investigating the probabilities of success or failure.

Speculators also hope for rapid growth (or rapid decline, in the case of short selling) with only modest concern about safety. Unlike the gamblers, however, they try to figure the odds for success or failure, and govern their actions accordingly. They are usually "in‑and‑outers," buying something, holding it briefly, and then selling it again. Their main objective is to make a quick profit and then get out. However, some speculators invest in enterprises that they do not expect to be profitable for years, in the hope that some time in the future they will become profitable investments and their speculation will pay off handsomely.

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

Most clients are interested primarily in substantial and stable income or in steady growth, or a combination of both. Like speculators, they carefully investigate the securities or plans in which they are interested. They weigh the probability of these satisfying their long‑range objectives. Then they govern their actions according to carefully thought out conclusions. Unlike speculators, they generally are interested in the long haul —the income and/or growth potentials over the years. When they make investments, they intend to hold on to them until they fail to live up to their expectations or when they can be replaced by something that they believe will do a better long term job for them.

Ages of Clients

The financial situations of people and their investment preferences are often affected by their age. Young adults who are on their own usually have little extra income for investment. However, if they live at home, their living expenses may be very low. Also, some young people are extremely talented and earn substantial incomes. In both of these situations, young people may be financially capable of making investments. Sometimes they are inclined to gamble or speculate, rather than make solid investments, especially if they are anxious to "strike it rich." If so, they will be attracted by growth funds and stocks. However, some young adults are extremely conservative and reflect this in their investment tastes.

Many middle aged people are in a position where they can set aside funds for investment, either on a lump sum or installment basis. They are usually more inclined to speculate than to gamble. But, most often, they are serious investors. Generally, stable investments like bonds, variable annuities and mutual funds will appeal to them.

People who are at or nearing retirement usually feel that whatever they have accumulated during their working years must be applied to satisfy their need for retirement funds. They are very concerned investors. They fully recognize that they can't afford to lose their principal since they will not have time enough to recoup any losses. They tend to look for safety of principal. Income is important, but preservation of capital is more important. Therefore, they usually are attracted by investments that provide safety of principal and fairly stable income; such as they might obtain from bonds, annuities, and conservative mutual funds.

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

As a professional financial planner you should not recommend the purchase of securities on either a lump sum or continuous installment basis in amounts which are inconsistent with the expectations or the needs of the client's financial situation.

The responsibility of suitability is a very serious one. To deal with it, first of all, you should seek to persuade your clients to disclose pertinent information about themselves which will help determine suitability. Not all the people you deal with will be willing to disclose all their personal and financial affairs. But, you must attempt to obtain as many pertinent facts as possible.

Financial Status of Clients

To determine the financial status of clients with whom you deal, it is best to use a Personal Balance Sheet and a Personal Income Statement form. The first form will disclose whether or not the clients have sums of money that they can invest, or whether they are presently accumulating funds that will be available in the near future. The second form will bring out whether or not they have discretionary or excess income that can be invested periodically. It will also help you to determine whether to recommend investments that are oriented toward capital growth or current income. Of course, the objective (or combination of objectives) that individuals will strive for is a personal matter for each to decide.

If current income is not needed, you may feel safe in recommending that dividends and capital gains distribution from stocks or mutual funds be reinvested rather than taken in cash. This normally helps to improve the investment value of their holdings.

Armed with a Personal Balance Sheet and a Personal Income Statement, you can more accurately determine clients' financial objectives and lifestyles. This helps you to maintain fair dealings with them by establishing satisfactory relationships. Once you have achieved this, you will likely generate future business with satisfied clients.

The Personal Balance Sheet

Although the format of the Personal Balance Sheet varies widely, its basic objective is always the same: to analyze what individuals own, as well as what they owe, in short, to determine their net worth.

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

Assets are equal to liabilities plus equity (or more familiarly assets minus liabilities equals net worth). The balance sheet lists the items making up both sides of the equation.

The Personal Income Statement

While a healthy net worth might indicate that the individual involved has the financial ability to expand investments, this is not always the case. It is equally important to examine income and expenditures. The Personal Income Statement is used to accomplish this.

This statement is a tool for analyzing what is most commonly referred to as a person's "budget." However, avoid using this term in talking to prospects and clients. It brings to mind some unpleasant connotations. To "budget" usually means that we must do without, and nobody likes that. So, instead of talking about budgets, talk about "cash flow planning" and "money management." Both of these are respectable business terms which mean: arranging financial affairs so that ends meet.

Cash Flow

Cash flow means the amount of cash coming in or going out. Like any business, to be successful, individuals must have more money coming in than going out. If they do, they have excess or disposable income. If they don't, they are doing a poor job of money management, and may be in serious financial trouble.

Income by Itself is Meaningless

An important point to keep in mind is that you cannot tell the investment potential of people merely by knowing about their incomes.

Individuals with the same incomes, but quite different expenses, cannot and should not be expected to undertake identical investment programs.

Income by itself is meaningless. Until you have analyzed how much cash is flowing in and how much is flowing out, there is no way you can tell how much , if anything, is left for investment. And if you are to avoid jeopardizing the financial future of people you deal with, whatever you propose must be suitable to their individual and particular situations.

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

Fixed Expenses

Counterbalancing income cash flow are fixed expenses. These include such items as fixed monthly expenditures for a mortgage (or rent), food, utilities, heat, medical and dental bills, costs of education, upkeep of car (including gas), home maintenance, allowances payable, cleaning and laundry, any additional taxes (e.g., property taxes), insurance premiums, etc.

Some financial planners also recommend that two specific kinds of savings be included in this listing:

(1) An emergency fund which, supplemented by unemployment insurance benefits, could keep the individuals going for at least six months if they become unemployed.

(2) A replacement fund that can be drawn on if large, unexpected expenses are incurred, such as uninsured hospital bills.

Estimated Variable Expenses

By subtracting fixed expenses from projected monthly incoming cash flow, you can arrive at the amount of money available to the client for variable expenses. These include such controllable items as clothing, entertainment, gifts, vacations, and contributions to charities. Hopefully, these expenses will not completely wipe out the balance.

If a reasonable amount of money is left over after subtracting both fixed and variable expenses, the client has discretionary or excess income that can be put to work. You can now help the client to determine the best investment that can be made to achieve his or her desired objectives.

# Step 2: The Right Type Of Investment

Once you have helped clients to identify their basic and collateral financial objectives, you are ready to move on to Step 2 in the procedure for establishing investment objectives. This involves helping them to determine what types of investments they should rely on to achieve those objectives.

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

Keeping in mind our foregoing classifications of investment objectives and the particular motives and situations underlying each class, let's consider the pertinent characteristics of each of the more common types of investment properties. Our purpose, of course, is to determine if and why a given type of property is or is not a suitable means of satisfying a given class of objectives. Where we find that general compatibility exists between an investment type and an objective class, we will discuss some additional considerations that should help in making intelligent evaluations of individual properties as solutions to specific objectives.

Basis of Evaluation

How can financial planners assist their clients in determining what investments to make?

If financial planners seek to determine the probable long‑range performance of a security by analyzing a corporation's earnings, capital stability, growth possibilities, market position, etc., they are utilizing a fundamental (or valuation) approach. (It is so‑called because such an approach is based on a study of the corporation itself and of the conditions that may affect it.)

"Short‑range traders" are those individuals who buy and sell rapidly, hoping to profit by small daily (and even hourly) changes in the market price of securities. They are interested primarily in when to buy and sell, not what to buy and sell. They analyze short‑term stock prices and trends and, from such data, forecast probable market behavior. This type of analysis is called "technical" (or "market") analysis.

Financial planners should discuss important considerations which can guide clients in determining the effectiveness and practicability of the properties when measured against their personal investment objectives. A careful analysis can determine the advisability of a client's: (1) acquiring; (2) retaining; or (3) disposing of investment property. It provides the best means of answering the question: "Should the recommended property be in my portfolio and, if so, is this the best time to acquire it?"

Investment Limitations Of Clients

Having helped your clients determine their basic objectives, and having helped them to select the right types of investments to achieve those objectives, you are now ready to make a recommendation of the right investments within the types selected.

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

In undertaking this selection, you need to consider carefully the investment limitations of your clients. For example, you should compare the ability of each property being considered to satisfy the client's specific objectives, as well as whether or not it is within the financial capacity of that individual.

Financial Considerations Prior To Investment

There are several major financial aspects to consider. For example:

*Importance of Cash Savings*

Some economists consider cash savings adequate if they total from three to six months of the client's income. If there is less than this sum on hand, it may be financially dangerous for that individual to make long‑term investments. Any unexpected needs for cash could force a liquidation of holdings. Often, forced surrender of investments causes a drastic shrinkage in their value. So protect your clients against this unpleasant experience. Don't encourage them to make any major investment unless you first determine that they have adequate cash savings.

On the other hand, if you find that the individuals you are dealing with have large sums in their savings accounts, you will need to recommend investments that fit into their overall objectives.

*Importance of Insurance*

Most people today are aware of the many forms of insurance they can purchase to protect themselves, their families, and their property against catastrophic events. They recognize that, in terms of the small premiums involved, they can reap rich benefits —mentally and emotionally, as well as financially.

Unfortunately, this is not true of every client. From time to time, you will find individuals who are not aware of the value of life, disability, medical, and property and casualty insurance. In such cases, you owe it to them to urge them to obtain the insurance protection they need before undertaking to build their investment portfolios.

The death of income‑earners represents a major threat to their families. Life insurance can provide protection against this hazard better than any other known medium.

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

Because life insurance matures for a magnified amount at the death of the insured, it cannot —and was not designed to perform all the functions which other investment properties fulfill.

Conversely, it is obvious that no other investment property can be a specific substitute for life insurance. Individuals also face the possibility of an economic death should they be among the thousands who, every year, are seriously disabled —some for the rest of their lives. Disability income insurance is vitally needed to replace this lost earning power, and is frequently overlooked by the income‑earner.

In view of the ever-mounting costs of medical care at home or in a hospital, medical insurance is a must today. Such insurance is readily available and heavily depended upon by millions of insureds. If you find that your clients don't have adequate medical insurance, you should urge them to take corrective action immediately.

In this world of accidents, fire, theft, and other losses, property and casualty insurance is also a must. Each individual should be sure that his or her needs for such insurance are thoroughly covered.

*Importance of a Properly Executed Will*

Properly executed wills are of special importance in financial planning. They can assure individuals that, when they die, their property will be disposed of as they intend and managed by an executor of their choice in a manner they desire and without delay.

When people die intestate (without wills), administrators are appointed by the courts. These estate representatives must make an inventory of the property left by the decedents and make distribution according to the laws of descent and distribution in their respective states. Often, this may be contrary to what the deceased estate owners would have desired.

*Possible Need To Consult Experts*

There are many types of investments available to individuals that can help them achieve their financial objectives. These include not only mutual funds and variable annuities, but also life and health insurance, common and preferred stocks, bonds of all types, and money market instruments. While you should possess broad understanding of financial planning, it would be unrealistic to expect you to be an expert in all the areas covered under that broad umbrella. Nor should you hold yourself out to your clients as having such understanding unless you are singularly unusual and truly an expert in each phase

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

that is encompassed by a total investment program. If you are not, you should not hesitate to advise your clients to seek appropriate advice from other experts whenever the need arises. Among the most important of these experts are insurance advisers, investment counselors, CPAs and attorneys that is encompassed by a total investment program. It is not uncommon for financial planners to be licensed to sell insurance. When this is the case, it is perfectly natural for them to offer clients advice about their insurance needs. Even after clients' insurance needs are fully satisfied, it is important that periodic reviews of their insurance holdings be made by insurance licensed registered representatives or insurance specialists in order to study how that insurance impacts the clients' overall financial objectives.

Investment Counselors. Constant skilled supervision is necessary if your clients are to avoid losses and obtain the maximum return on their investments. Individual investors and anyone who supervises their investments should make caution a watchword.

If your clients wish to minimize the attention required by their investment portfolios, they can seek the services of the investment department of a trust company or a professional money manager. This is very worthwhile since it frees the investor of the need to constantly supervise their portfolios, day in and day out. Thus they are free to devote themselves to their normal activities or occupations.

Attorneys. Unless financial planners are licensed attorneys, they should never offer clients legal advice. They should urge them to obtain from their attorneys any legal advice they need in making investment decisions. By seeking legal counsel, investors often can avoid serious financial consequences that might occur because they overlooked some tax situation or were unaware of inherent legal entanglements.

While financial planners are free to help prospects and clients structure their investment programs, in no case should they ever attempt to draw up wills or other legal documents. Legal counsel should always be sought in the preparation of wills, and other legal agreements, etc. This is the attorney's job. Even if financial planners merely offer legal advice, they stand in danger of being charged with engaging in the unauthorized practice of law.

Another very important factor to consider pertaining to investment limitations of clients is the one that relates the risks involved in each property to the individual's temperament and ability to cope with those risks. Always ask: "Can they tolerate the risks involved? Are they within their comfort zones?"

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

*Ability to Risk Fluctuations in Value of Invested Capital*

In selecting investments, clients should recognize the fact that they will need to face the risk of having the capital they invest fluctuate in value.To be able to withstand the temptation to sell out when prices head down, clients should be financially and mentally able to hold on to their stocks until things turn up. This might be a long time coming, and investors should recognize this when they buy stock. If individuals are not predisposed to hold on to stocks that are heading down, they should at least be financially able to absorb the losses they might sustain. Otherwise, they might be better off investing in less risky investments.

Clients should also be aware that bonds can expose them to similar market risks. For example, a 5% bond which matures in 25 years may suffer a capital shrinkage if, during that time, interest rates go up sharply. Assume that bond rates climb to 8% at a time when a bondholder must sell a $10,000, 5% bond. Will it bring back the investor's original investment of $10,000? Of course not.. The 5% rate is equal only to 62 1/2% of the going rate of 8%. Therefore, it probably will sell for about $6,250, causing the bondholder to suffer a capital shrinkage of $3,750.

You should make sure that all of your clients fully understand that such fluctuations may affect their capital investments adversely, as well as positively. Unless your clients are ready to absorb loss of capital as well as to enjoy possible capital appreciation, they should be counseled to stay out of the securities market. Its risks are beyond their comfort zones.

*Ability to Risk Fluctuations in Amount of Income in Current Dollars*

You have an obligation to inform your clients that by purchasing certain securities or investments they face the risk of fluctuations in the amount of current‑dollar income they will receive.

For example, if you recommend variable annuities, be sure to point out that, while the number of annuity units will be fixed when payout begins, the amount of current dollars they receive will vary. This will depend on the economic factors and market conditions, which affect the separate accounts underlying their annuities. If your clients are not financially or emotionally capable of accepting such fluctuations in current‑dollar income, they should be counseled not to buy variable annuities.

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

*Need For Liquidity*

An important consideration in any investment is the need for liquidity. Clients who have insufficient income or who may possibly incur unforeseen expenses at a future time must consider: (1) how quickly their investment can be converted into cash; and (2) the consequences of conversion into cash at an inappropriate time. Obviously, real estate investments are less liquid than securities investments. However, even with securities investments, objectives should be made over the long term and if the client requires a high degree of liquidity, he or she may find it necessary to convert securities into cash when market conditions are unfavorable.

# Step 3: The Proper Time To Buy Or Sell

The fourth step in formulating investment programs to achieve the investment objectives of clients involves the timing of purchases and sales of securities.

Once clients have selected the best investments, they should obtain them at the best possible prices: timing is important. If the prices are currently high, clients might be well advised to wait until the prices become more realistic. if their decisions to buy depend on selling some other investments, they should be counseled to make the sales only when conditions are right. Otherwise, they may suffer unnecessary losses.

In answering the question, "When to invest?" essentially there are three schools of thought with respect to the timing of purchases or sales of securities. They are: buy and hold; aggressive; and defensive.

Buy And Hold

The "buy and hold" school believes that good stocks of established companies are bound to increase over long periods of time. The general level of securities' prices has always done so. This general theory may be a good one if the right stocks are selected and the investor is in a financial position to hold during all future periods of market decline. The theory might be a hazardous one unless both of these conditions are met. Even then, selling securities at an unfavorable time might be required if the investor dies.

Aggressive Portfolio Policies

A second group of investors and portfolio managers believes that price changes can be gauged and profited from. Their motto is, "Buy at relatively low prices and sell at

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

relatively high ones. 11 They are said to be following an aggressive portfolio policy —one that has a high portfolio turnover.

Defensive Portfolio Policies

A third group believes that price changes are extremely difficult to predict and, anyway, the long‑term period is upward. Therefore, they ignore price movement and agree that purchases should be made whenever funds are available without regard to market prices. They are said to be following a defensive portfolio policy. They are engaging in "time diversification" by spacing purchases and sales over time, and relying on the long‑term upward trend in the stock market to produce satisfactory results. A Monthly Investment Plan is an example of a "time diversification" strategies.

Dollar Cost Averaging

This is the most popular of the defensive portfolio policies. The investor who pursues this strategy invests the same dollar amount in a security at regular, fixed‑time intervals (e.g., monthly, quarterly). The purchases are made without regard to the current price of the security. More shares of the security are bought when the price is low and fewer shares are bought when it is high.

Since dollar cost averaging is systematic, and the long‑term market trend has been upward, this strategy has been used successfully by many investors.

Of course, dollar cost averaging does not assure a profit or protect against a loss in declining markets. And, of course, even the regular investors would lose if they redeemed their shares when their total market values were less than their costs. But dollar cost averaging has proven to be a beneficial form of investment for the long‑term investors whose financial situation permits them to pursue this strategy in good and bad times.

One drawback of this strategy is that it provides no guidance as to when the investor should sell.

Portfolio Turnover

Whether the policy followed is aggressive or defensive, no investment portfolio should be allowed to sit unattended. It should be carefully reviewed periodically to determine whether it might be wise to sell one investment and buy another, or, perhaps to keep the proceeds liquid, rather than invested.

Identification and Analysis of the Clients Goals, Objectives, and Risk Profile

Summary

Use of the four step evaluation procedure we have discussed, combined with an understanding of investment properties, should prove most valuable as you seek to help clients make the right decisions whenever a question arises as to the advisability of buying, holding, or selling particular property. Moreover, it should provide the best possible means of avoiding (or unscrambling) investment portfolios that consist of an unorganized mass of property accumulated over a period of years often without regard to the special needs of the owners, their families or their estates.

The use of this evaluation procedure will permit as high a degree of objectivity as can be expected in weighing the components of a given financial plan. Peculiarly, the investment of a person's money often is charged with emotion, and when an opinion is expressed which is contradictory to the individual's beliefs and convictions, it is apt to stir up a hornet's nest. The frequent result is a stalemate: a possible sale postponed and a potential client lost.

However, if a penetrating look at an individual's financial program can be made in the cool light of analytical appraisal, and if the various investments can be weighed against the objectives which the client has stated, then the choice of acquisition or disposition becomes less difficult.