Morningstar Behavioral
Finance for Advisors

Modern Goals:
Behavioral Strategies for Long-Term Success

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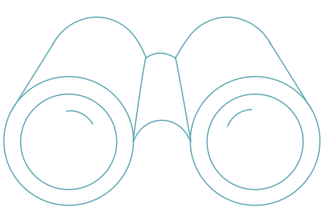
Managing your clients' financial goals and keeping them on track with those goals is a key aspect of the advisor/client relationship. But goal-setting is filled with challenges both for advisors, who have a vested interest in keeping their clients on target, and their clients, who might not be able to tell the difference between goals they want, goals they need, and goals they can actually achieve.

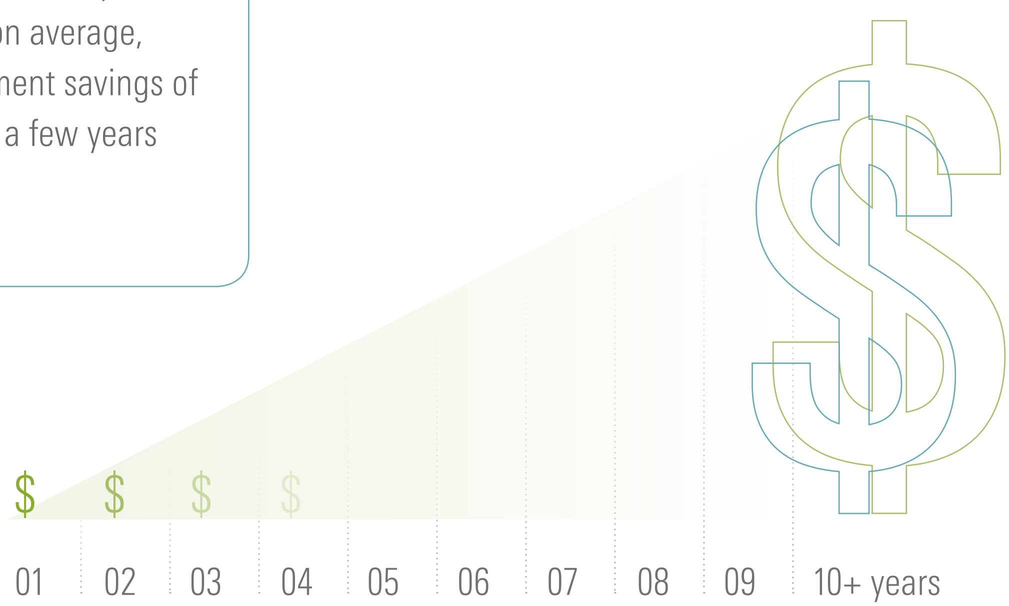
Morningstar behavioral economist Sarah Newcomb, Ph.D., author of *Loaded: Money, Psychology, and How to Get Ahead Without Leaving Your Values Behind*, has researched the psychology of goal-setting, and she said advisors use it to craft realistic, meaningful, and achievable goals that benefit advisors and clients alike.

"I do a lot of research into how the way that we think about time affects our financial decisions, and what I'm finding over and over again is that the further that someone thinks ahead, and the clearer their picture of the future is, the better decisions they make financially," Newcomb said.

"They have more saved for retirement, and they have more non-retirement savings. This long-term mindset alters the course of our financial lives in a large way."

"People who think 10 or more years into the future have, on average, eight times the retirement savings of people who just think a few years or less."

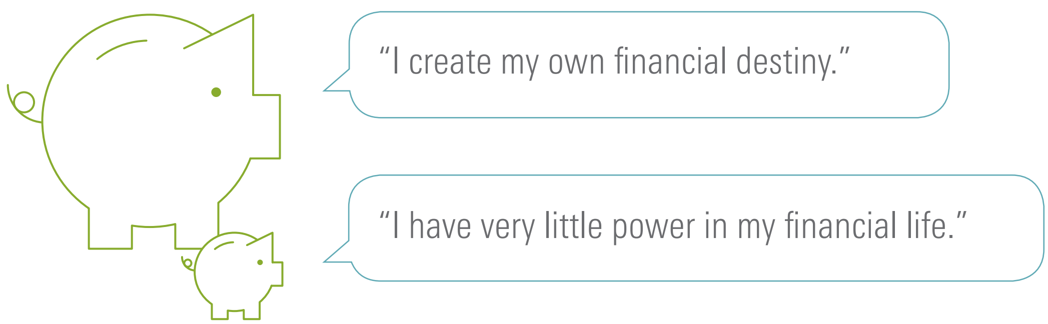




Destiny Versus Self-Determination

Mentally picturing the future isn't easy, and it can be particularly difficult to envision long-term goals when your clients don't feel like they have any control of their financial future. Newcomb's interviews with investors underlined the need for your clients to feel like they are really in charge of their money.

"I asked people which statement they agreed with more: 'I create my financial destiny,' or 'I have very little power in my financial life,' " Newcomb said. "They had to choose one or the other. Then I looked at what they said they had in retirement savings. The people who believed they create their own financial destiny had about 2.7 times more money in retirement savings than those who didn't believe that."



Dispelling Delusions

While empowering your clients is an essential part of goal-setting, it hinges on having goals that both you and your clients believe are achievable.

"If your clients really think a goal is in their power to do it, that's a good goal," Newcomb said. "If you don't think that you can do it, then you won't, and it actually becomes disempowering to think about it."

"The first thing advisors want to do is say, 'Is this goal possible? Do these clients have the means, if they changed some of their behavior, to actually reach the goals they want?' Then advisors can focus on helping clients through these little mental tricks to reach a mindset that's more conducive to reaching their goals," Newcomb said. "I hear stories from advisors about people who are wealthy now but eventually won't be, because of their spending habits. Not only will they be unable to retire, they'll probably not have enough assets to need a financial planner in 10 years, if they don't cool it.

"They're out of touch. They're apathetic, avoiding the truth, or they just enjoy spending too much." In this case, advisors need to talk about quality of life.

"They can tell these clients, 'If you continue on this trend, let's talk about your about quality of life in 10 years, or 20 years. Let's look at what you can afford and what that life is going to look like,' " Newcomb said. "By getting the clients to see some details, they may say, 'Oh, I don't want to live like that. What do I have to do now so that I can live better then?' "

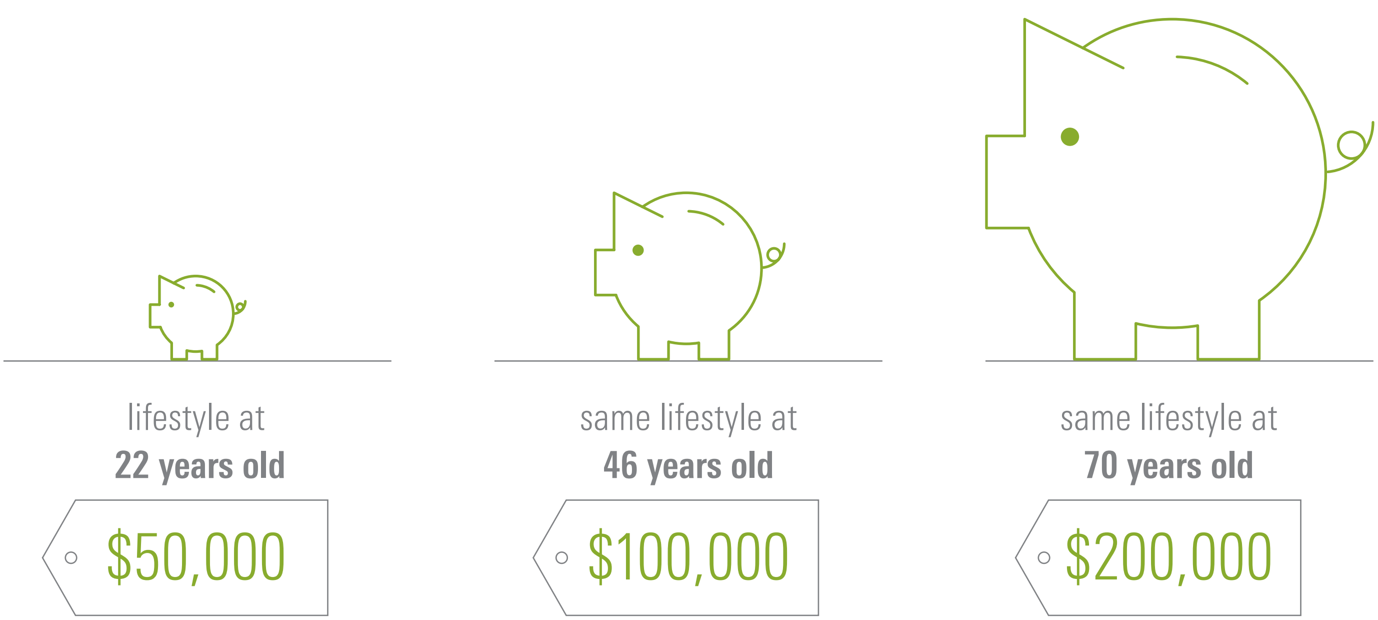
From Spreadsheets to Stories

Taking your clients' information and turning it into real-life scenarios is crucial, because showing them spreadsheets or a screen full of data won't cut it in most cases.

"Clients will say, 'Oh, I've got $5 million. I'm fine.' Actually, when they retire in 25 years, that $5 million is going to be half as valuable. There's a disconnect between a lump sum of money and what that lump sum translates into in terms of long-term income," Newcomb said. "So, you have to do the math for them. What financial advisors need to understand is that for most people, numbers are far too abstract. You need to translate the numbers into a narrative, a story, about what the clients' lives will look like. If that life is, 'Right now you're going to have about enough money to sit in front of a cable box for 10 years,' then that's the story you need to tell them, in a gentle way."

"Take that lump sum and show your clients what that means in terms of monthly income, so they understand why their lump sum is actually not as big as it needs to be. People don't do mental math very well, so turning that lump sum into actual monthly income amounts frames the discussion in a way your clients can see more easily," Newcomb said. "Then, they can start translating that into what their lives would look like if that was their only income. Then, the connection between the short term and the long term starts forming."

Putting Lump Sums Into Perspective If your clients think a lump sum will sustain them through retirement, help them visualize what that amount means for their lifestyle over time.



Tools for Success: Mental Contrasting Can Be Crucial

"When I tell people they likely need millions of dollars to be financially stable and not outlive their money in retirement, they say, 'Oh, I can't. It's impossible. I can't do that,' and they just want to give up. Advisors have to be careful of that, because when people don't feel powerful, they give up and they shut down," Newcomb said. "You have to help clients understand that they can reach these seemingly unreachable amounts. They must start now and they have to plan well, but there are ways to do it. This is where really cool research on what's called mental contrasting[1] comes into play.

> "The people who use mental contrasting tend to save more for retirement and be more successful at reaching their goals than people that just use positive fantasy as a motivator."

"First of all, get clients to think about the future that they want; think about how wonderful it will be to retire and spend all their time gardening and reading books," she said. "Most people do that and stop. But it turns out that it's powerful and effective for people to think about one obstacle that's in their way, between here and that ideal future. Just one thing that they believe they can overcome. Maybe it's a Friday night spending binge at the mall. Or maybe it's a pricey dinner every week. Whatever it is, it has to make them say, 'That's the thing. I'm overspending in this area, and that's one obstacle keeping me from really saving enough for retirement.'

"If it's an obstacle that they don't honestly believe they can change, it will backfire. But if it's an obstacle that they believe is in their power to overcome, then their brains attach success to overcoming that obstacle," Newcomb said. "The people who use mental contrasting tend to save more for retirement and be more successful at reaching their goals than people that just use positive fantasy as a motivator."

A Blueprint for Realistic Goal-Setting

Newcomb outlined a way for advisors to put all of these steps into practice, running through a scenario that she's heard from multiple advisors.

"Let's say you have clients that are pretty affluent, but they're not thinking far enough ahead, so they're not saving enough to reach all their goals. They might be able to reach two out of their three high-priority goals, but the long-term picture doesn't look good," Newcomb said. "The first thing to do is try to move them toward financial health--get them to think a little further ahead. If they're thinking five years ahead, get them to make a 10-year plan. Get them to picture their life 10 years from now, to really think about the life that they're working toward, a life they can really dream about.

"If your clients are struggling in any way or feel powerless in their financial lives, you can draw their attention to the ways in which they do have autonomy and power. You can show these clients how their choices are powerful. By doing that, you might be able to move them to boost their savings rate and reach all of their goals in time."

1 NYU Professor of Psychology Gabriele Oettingen pioneered the research on mental contrasting. psych.nyu.edu/oettingen

Once a strong core of realistic goals is set, you can start looking at possibilities for future goals, and prioritizing them.

"We all would love to never outlive our money, leave a legacy to our children and grandchildren, pay for all of our health costs in retirement, travel the world, and die with dignity while never being a burden on our children. But the reality is that a lot of times we're not going to have enough to meet all those goals," Newcomb said. "We have to prioritize them. We have to figure out, 'OK, if I had to choose between covering all my healthcare costs or not being a burden on my children, which one is most important to me? Prioritizing goals is hard, and clients really hate this process, because it's painful. But it's one of those things that they will be grateful for having done in the end, because it brings a lot of clarity. Hopefully, it puts them on a path toward reaching their big goals and branching off from there toward more realistic, achievable goals down the line."

Recommended Reading

Thinking Smarter: Seven Steps to Your Fulfilling Retirement...and Life, by Schlomo Benartzi

"*Thinking Smarter* has seven steps for advisors to help their clients reach their goals. It's based on work Benartzi and his colleagues did in an academic setting, where they gave people 20 minutes to sit down and really think through their goals for retirement, what they wanted their quality of life to be like, what were the most important factors for them about their quality of life in retirement, and list all the goals they could think of," Newcomb said. "Then they gave the same people a checklist of some common reasons why people strive for retirement, or goals for people in retirement." Specifically, there were things like being able to die with dignity, or not being a burden on their children, or being able to travel, or being able to leave a legacy to their children and grandchildren. "They found that the people, even though they had a lot of time to think through what their goals were, had things on that list that they hadn't even thought of and they turned out to often be more important than the things they came up with," she said. "Identifying goals is a challenge, and we need a little bit of help to do that, but a checklist is a pretty quick and easy fix for that problem."

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