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Planning & Common Language: Keys to Retiree Confidence

By Wayne von Borstel

Retirees whose portfolios have been 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, and retiree 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 happen to trigger the downslide nor how fast or how far. But 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 mean values 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 rewards smart investors over the long term.

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

Let's 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 afterwards. I rarely find an investor who can accurately define their investment strategy. They might say they are “conservative” or “moderately aggressive” or “opportunistic”. Their description usually mimics the terminology used by the person who created their investment portfolio, but most of the time, the investor hasn’t a clue as to what that terminology means. I don’t mean to say they are stupid; they usually think they know what they mean. But rarely does their portfolio composition reflect their description. Often, the two are not even close.

The longtime advisor to an 85-year old woman died. His son took over the business but the woman wasn’t comfortable with the young fellow and expressed her feelings to her 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 oratory on 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 silent and listened as she went on about how she didn’t want to take any risks with her investment capital. At about the 30-minute mark, I made a mental note that this was a dead issue because 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% individual stocks! Somebody had 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. 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 her 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 didn’t say so, I think she continued to have some misgivings about our revised asset allocation, right up until when the markets tanked and she would have lost a major portion of her portfolio had we not made the changes.

Now we are pals.

In another case, an elderly man who had been a financial advisor with a successful practice engaged me to help manage his retirement portfolio. I had more problems discussing terms with him than with ordinary clients. He is very knowledgeable and knows what he means but we find we often use different terminology or have different definitions for the same terms. I'll bet if you asked a dozen advisors what "moderately aggressive" means to them, you would get several different and dissimilar meanings. There is simply no common language.

Every experienced advisor has encountered situations like this at one time or another. We scratch our heads and wonder what the other advisor was thinking. While stuffing a portfolio with individual stocks for an 85-year old widow is no doubt an extreme example and clearly involves something more disturbing than poor communication, in most cases the reason portfolios are not aligned appropriately with investor objectives is miscommunication, or lack of a common language. Investors and advisors may be using the same terms, but either they have a different understanding of what those terms mean, or the advisor assumed instead of probing more deeply to make certain.

Since there is no common language, it's up to advisors to take the lead and make sure each client understands the language we are using. It's 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've learned a few words but I have no in-depth or accurate understanding of the language. Fortunately, my wife does and so we get along fine. In a way, it's the same for most people when they talk to their advisors. They've picked up some words and phrases here and there but the one side may as well be speaking Spanish.

If we have established a trust relationship, our clients tend to believe what we recommend is right for them. But do they really understand what we are saying? Do we really understand what they mean? Are they sufficiently comfortable that, when necessary, they can express that they don't 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 takes more time and I suspect some of our clients will even resist having us go into more detail than they are accustomed, but if we do, when times get bad such as they are right now, clients can believe in and fall back on the strategies we developed in the planning process. That's what will help give them confidence in hard times and that's 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 level of risk involved and how our plan will function, in good times and bad. All this has to be expressed and

understood in a common language. If not, it won't work. When people speak and can't 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 them 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, or about once every four years. Of course, when these losses will occur is unpredictable. Retirees with 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. Markets are not always going to rise; inflation is not always going to be low; our 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 a non-event.

We have to instill retiree focus and confidence in the planning process. Portfolios may go down but with a good plan, not as much as the broad markets, and certainly not enough to force lifestyle changes or trigger panic. The biggest enemy in times like these is being forced to spend investment capital. Retirees must have a plan in place for times like this, typically one that includes that includes six months of emergency funds, five year's 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 the loss of financial confidence and that may be an irretrievable loss.

Current events have proven to me that all the work we 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 didn't want to hear it when the markets were soaring.

Generally speaking, I think there are two opposing postures within the financial services industry. The majority position is to utilize analysis, software or system to determine which stocks, industries or sectors are going to outperform others and structure client portfolios to match that evaluation. If something goes wrong, a new answer is developed and tried. Of course, this is not a solution but it does help clients feel better when they take a hit and it also keeps them

searching for the eternally elusive secret to performance. The alternative and less popular approach 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'm 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 willing 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's not so 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's it. So logically, that's where our focus should be. We need a plan so when things go wrong, our clients can expect to survive.

Never Too Late

It's almost never too late for good planning. Investing doesn't end when we retire, that's only halftime of the game. We still have to play the second half. While we are working, we're 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 what we wish to leave to our heirs and perhaps charity. The game becomes one of how to preserve wealth for our family and 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 eventual declining health. That team takes the field and plays whether we do or not. If we don't 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, 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 to advisors. The mass media likes to hype the "investment strategy du jour" at the expense of planning because it's a juicier topic and generates more interest. In addition, it's 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."

As advisors, I think we have to take the lead in changing the public's perception of what is more important, planning or management. We have to try to help calm investors fears and guide them towards becoming confident as the result of having a solid but flexible financial plan 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 sponsor 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 don't. Their brokers have stopped calling them or if they do call, it's to beg them to "stay the course" or some similar bromide. But what value does that advice hold when retirees are spending out of a down market?

Clients sometimes have been left to fend for themselves while mulling their decision to chase investment returns without a formal planning process. Investors with 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 don't 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, to fall back on.

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 as hot segments and ignore the need for portfolio diversity.

During the historic market run up the past few years, many of us continued to stress the importance of having a sound plan in place to help compensate for the inevitable downturn. Not all of our clients listened. Among those who did, many are weathering the storm without irreparable damage to their financial ships. That's not to say they have not experienced angst or losses, but it's one thing to be down 40% in a market down 50%; it's quite another to be down 90%. For retirees with significantly eroded investment capital, the loss is debilitating since it can no longer generate adequate income. Just as bad, seniors may lack the time to recover or the ability to return to the workforce.

Recently, several people who are not clients approached me after church

services, lamenting how they have lost 80 or 90% 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 advisor was doing. None believed they were taking extraordinary risk; none thought they could suffer an almost complete erosion of their investment capital. It was heartbreaking to hear their stories.

And 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" for the huddled masses, yearning for a safe haven. The underlying and unspoken truth is 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 can't hit the ball nearly as well? Because he doesn't know when his swing will get out of tempo or when he will get into a bad habit, and he realizes he needs someone watching to help him get back on track when something goes wrong. Just like great athletes, we get the most out of our 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 rattles the markets to their foundations. It may be an act of terrorism, political lunacy, a financial meltdown, a scandal or 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 plan, many investors will no doubt overreact and do something ill advised that will cost them dearly.

As 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 by crafting plans that will help them maintain their emotional equilibrium and continue to make good decisions 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, the plan we created together, the plan they have looked at a dozen times and have grown comfortable with. 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's likely they will still be on target towards meeting their goals. Just as important, they will be able to cope with the inevitable setbacks because the plan is solid, they understand it, their investment strategy mirrors their goals, and they can cope with the passing economic storm, typically with only minor adjustments.

Bio

Wayne von Borstel, CLU, ChFC, CFP®, MSFS, CAP, is founder and president of Oregon Trail Financial Services, a registered investment advisor company with offices in Portland, The Dalles and Redmond, Oregon. Wayne is a registered representative with and securities offered through LPL Financial, member FINRA/SIPC. He can be reached at 541.296.6669 or wayne@vonborstel.com.