

Many advisors use risk tolerance to determine how to allocate client assets, putting clients in buckets of conservative, moderate or aggressive based on the question “How scared are you?” This approach can result in poor risk management, significant misallocation of resources and a high degree of anxiety. A better approach is to use a needs-based planning process to match resources to client goals.



In the needs-based allocation approach, the goal is to optimize available resources. For example, you can use insurance solutions to mitigate catastrophic risk, set aside cash for liquidity and then allocate remaining capital to investments designed for income and long-term growth. The resulting answer is rarely 60% equities and 40% bonds. The needs-based approach helps to ensure specific short-term needs are being met while allowing long-term investments to grow over time. Each year, or as events arise, the allocation can be adjusted for changing circumstances. This all leads to higher levels of confidence, control and comfort which reduces anxiety and allows investors and advisors to stay on track during challenging times.

# behavioral ADVISOR

## From the Behavioral Viewpoint

What is going on?

1. Investors and advisors have a **present bias**, where they don't consider the future enough and focus on the present instead. Thus, they over-allocate to short-term comfort at the expense of long term wealth.
2. Planning requires time, effort and discipline. The industry offers a simple solution in the form of suitability and risk tolerance. Advisors and investors substitute this for the real work of matching resources to needs.
3. There is an **availability** and **confirmation bias** in the form of the widely available and heavily promoted risk tolerance questionnaires and risk-based portfolio solutions, accelerated and propagated by technology and regulators.

What can we do?

1. Develop a comprehensive needs-based financial plan that maps resources to goals.
2. Utilize specialized solutions and expertise within each needs category.
3. Measure progress towards established goals and revisit the plan regularly to reflect evolving circumstances and events.
4. Work with a skilled advisor who can provide valuable education, perspective and coaching.

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