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Future Returns: Invest for Goals Instead of Returns

By Abby Schultz

Northern Trust has discovered the best way to bring female clients into the investment process is to show how their portfolio can fund their current lifestyle and their goals, instead of talking about how they are going to invest to beat the market.

This is important because women are increasingly taking a lead role in their family's finances, either intentionally or unintentionally, through "death, divorce, and inheritance," says Katie Nixon, chief investment officer for Northern Trust Wealth Management. While women hold about 40% of investable assets today, there are predictions that percentage could rise to more than 66% in the next 20 years.

Investing in stocks, bonds, hedge funds, or anything else, resonates for women when the discussion turns to how their investments will pay for their children's college education, or allow them to give to a cherished philanthropic cause, or pay for a vacation home at the beach. For women, generally, achieving top-notch investment performance is only meaningful if it leads toward funding an important goal or outcome, Nixon says.

The firm also finds the goals-based framework they've developed draws women into investment meetings they used to leave to their husbands. When the discussion centers on goals, couples often end up talking about topics they never broached before, like, how much do we want to leave our children? Or, when should we retire?

"I've been in meetings where the husband and wife start to talk about issues that they've never really talked about before," Nixon says.

Goals Cost Money

For Nixon, the advantage of building an investment portfolio around goals is that goals cost money. "I can measure how much they cost, and I can estimate how much they will cost in the future," she says.

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The goals-based process begins with a balance sheet statement of assets and liabilities, including an income statement. It answers questions like: "What are your cash flows? What are your assets? How are they titled? What is liquid or illiquid? How much of your balance sheet is tied up in human capital. Are you working? How long will you be working?" Nixon says.

Here's where things really get different. Instead of asking clients the most common question in wealth management: "What is your risk tolerance?" Northern Trust advisors ask "what are your goals?"

"Nobody has any idea what their risk tolerance is," Nixon says.

But they do have an idea of what they want for their family or philanthropy, even what their discretionary spending may be. "We can have a discussion with a client that could end with a list that's 60 goals long—everything from education to weddings to car purchases, vacation homes, and legacy gifts to their alma mater," she says. "The list can go on and on."

The goals, no matter how many of them there are, can then be quantified according to present value, an economic calculation that accounts for the future value of an obligation, or a goal in this case. Then the client can see whether or not their investment portfolio is sufficient to pay for their goals.

"For a lot of women, that's a big sigh of relief, to know they have enough to fund a lifetime of goals," she says. If they don't have enough, then it's time to talk about what changes they can make so they can ultimately achieve them.

Building an Investment Strategy

Since goals are different in terms of their magnitude, timing, duration, and inflation sensitivity, each requires its

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own investment strategy. Essentially, it's a matter of asset-liability matching, Nixon says.

Broadly, Northern Trust divides the investment world into two kinds of assets: risky assets (like stocks) and risk-controlled assets (like most bonds).

"The allocation between the two will be defined by the timing, duration, and nature of the goal," Nixon says.

The goal clients want to protect the most is their lifestyle. Because lifestyle spending is sensitive to inflation, the wealth manager recommends funding it with risk-controlled assets, primarily high-quality fixed-income with inflation protection.

For long-term goals that don't have to be funded for 10 to 15 years, clients can invest in risk assets. "As the years go by, you de-risk that portfolio along a glide path to the point it needs to be funded," she says, meaning, 100% of the funds are in risk-controlled assets.

Northern Trust relies on technology to help assign the appropriate asset allocation between risk and risk-controlled assets to match the goals. A client with 60 goals doesn't have 60 portfolios, then, but one that represents "the amalgamation of all the goals and all the different asset allocations," Nixon says.

"Our portfolio managers, because they are attuned to the technology, can rebalance the portfolio as needed based on how the goals are moving," she says. "It's not putting you in a 60/40 portfolio because you're moderate risk—this is dynamic over time. As your situation changes, as conditions change, we can add and remove goals, or de-prioritize goals."

What Does a Goals-Based Approach Change?

When investors focus on goals instead of risk tolerance, they often realize their investments are skewed conservatively, with too much in cash and bonds. "We're able to liberate a lot of risk capital assets and cash that's been sitting on the sidelines and not intentionally invested," Nixon says.

Also, investors have been reluctant to tie up their assets in long-term private equity funds, real estate, and other so-called illiquid assets. By assessing what they have in relation to what they want to fund, investors often realize they can take more "liquidity risk," Nixon says. "They'll say, 'I can have more private equity because I have more than enough and I know I won't need this liquidity, maybe ever.' That's been really positive."