Nationwide®
is on your side

81% of investors prefer to work with an advisor qualified to review all areas of financial life versus working with specialists.[1]

Goals-based Planning and Outcome-oriented Solutions

The changing roles of advisors and starting new conversations

A Nationwide® White Paper by Timothy Rooney

March 24, 2015

When I was an advisor in the 1980s, we were often called stockbrokers and the value we brought to clients was investment performance. Our value proposition was to bring the best securities to clients' portfolios. That's where our time and energy went.

Over the last few decades the role of the advisor transitioned from broker to investment advisor, with advisors shifting away from building every portfolio with individual securities. Today, advisors allocate roughly 35% of their clients' portfolios to mutual funds.[2]

[1] Source: Think Advisor - Orc International Investor Survey, November, 2014.
[2] Cogent Wealth Reports: Advisor Brandscape. July, 2014.

With the emergence of roboadvisors, the increasing complexities of the financial landscape, longer life spans and thus longer retirements to fund, clients are increasingly requiring another evolution from a focus on the investment portfolio to an emphasis on the clients' holistic needs and how those needs intersect with their life goals.

Nationwide recently spent several days interviewing clients about what they need and look for from their advisors in this changing world. And what came through loud and clear is that clients want to work with advisors who understand their aspirations and focus on their futures.

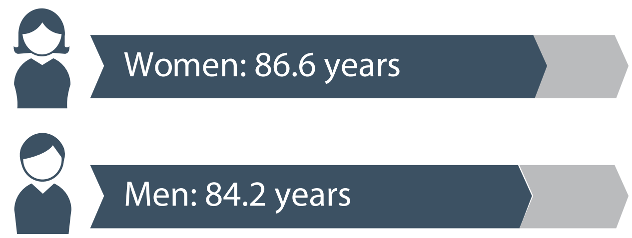
"My advisor *should be able to give me* a clear and concise *picture of my future."*

"My advisor **should be an expert** *no matter what my needs* **— know my goals and expectations."**

"My advisor **should focus on my plans** and how something fits into that picture."

As a former advisor, I don't envy you today. You have it harder than I did. Not only do you need to be able to help clients see a clear picture of their future, but you have more obstacles to plan for — rising health care costs, longer retirements, less certainty with Social Security and pension plans. With the advent of 24-hour news from every direction, clients' emotions play an even bigger role in the equation than they ever have. Some become anxious with every new bit of information and want to make changes at exactly the wrong times, while others are so overwhelmed that they can be apathetic about making decisions.

Figure 1. Life Expectancy at Age 65 (2013)



Life Expectancy Calculator. Social Security Online.
http://www.ssa.gov/OACT/population/longevity.html

Health care spending **is projected to grow** 5.8% *each year* through 2022.[3]

The average 65-year-old American *will spend* **20** years in retirement **and is looking to you** *to help them manage.*

[3] "National Health Expenditure Projections, 2012-2022. Slow Growth Until Coverage Expands and Economy Improves." Health Affairs, September 2013.

And of course — then there's the topic that will not go away — the recession! It revealed cracks in the main investment principles and philosophies that the industry has been using for decades. Our noncorrelated investments turned out to be very much correlated. And the casualty of this revelation was investor confidence. Clients flocked to fixed investments, even cash holdings. While institutional investors made adjustments, added more diverse alternatives to the mix and stayed invested in equities to experience the "bounce back", the stark reality is that many retail investors didn't.

HELPING CLIENTS REBUILD CONFIDENCE

So how can you help investors find their confidence again and how can you meet clients' ever-growing expectations of holistic life planning? We think you can do it with a broader goals-based planning method that incorporates clients' life goals and investment objectives.

In an effort to optimize client returns, advisors generally talk to clients about their goals, assess risk tolerance and build an optimized portfolio. The problem with this approach in today's environment is that it too often means that the only way clients have to evaluate success is to look at overall returns against a benchmark. Knowing that clients' emotions are heightened after the recession, this isn't optimal for clients or for you.

What could help clients feel better about their ability to achieve their goals is a goal-based planning - a process in which you construct individual portfolios around specific client goals or needs.

GOALS-BASED PLANNING HOW IT WORKS

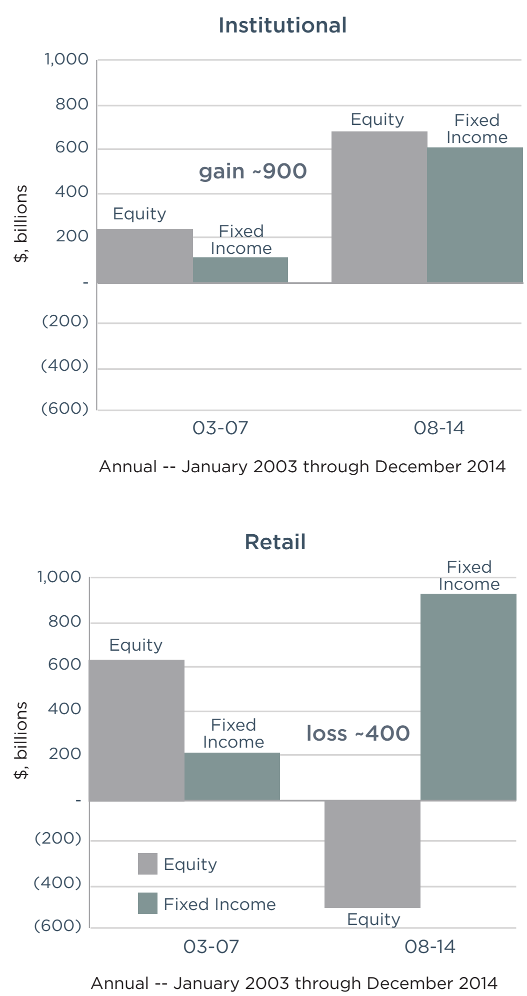
Goals-based planning is a holistic planning approach that ties specific investment strategies to individual client goals and results in a highly personalized plan based on each client's unique goals, as well as the level of acceptable risk and timing of those goals.

Basically, the focus is to develop multiple portfolios, each with a risk/return profile that aligns to a specific client goal. As you and your clients are talking about goals, you work together to prioritize the goals into categories —

Risk aversion: Institutional vs. Retail Client Behavior

Investors who are risk averse make decisions based primarily on perceived risk and their dislike of risk. This can lead investors to seek out "safe" investments with lower returns even if it means sacrificing their ability to achieve long-term goals. This phenomenon has played out since the downturn of 2008. After the downturn of 2008, there was a dramatic shift from equity to fixed income. While institutional investors maintained and rebuilt exposures, retail investors have not. Had retail clients kept their investments in the market, they would have more than made up the losses of 2008.

Figure 2. Institutional vs. Retail Behavior Outcomes



Source: Investment Company Institute (ICI); Bloomberg.

essentials, desires and aspirations — and to assign basic time parameters for each goal — short term, intermediate or long term. You'll also discuss your clients' risk capacity for each goal.

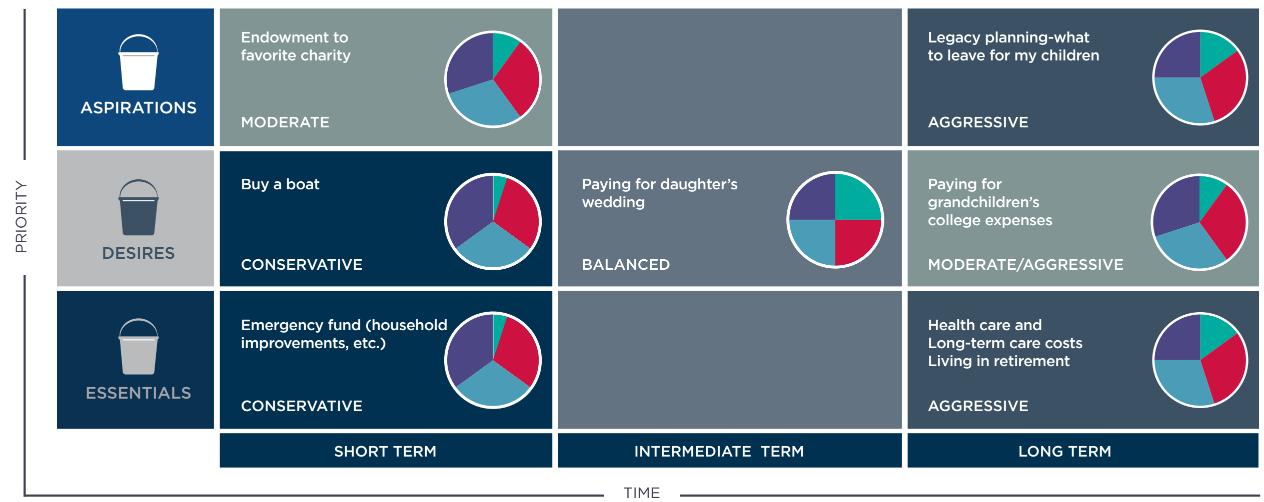
For example, fixing a client's leaky roof is likely to be a short-term essential requiring liquidity and therefore fairly low risk, while accumulating savings to fund health care costs or long-term care needs in retirement might be a long-term essential for which more risk is tolerable.

Goals such as purchasing a boat or funding a grandchild's college education or wedding could be included in the desires bucket. In this context of real goals, a client is likely to feel comfortable with more risk for these items than for those in the essentials bucket.

Finally, you go through the same process when reviewing aspirations. This bucket might include the purchase of a second home or endowment or legacy planning goals. While a client certainly wants to achieve all of these goals, just the basic exercise of you and the client layering his or her needs makes it easier for a client to prioritize and adjust expectations.

> **83%**
> *of investors*
> **fear another financial crisis**
> *like that of 2008.*
> *Nationwide Fear of Financial Planning Study, 2013*

Figure 3. Goals-based Planning



Source: Nationwide

Goals-based planning is based on the unique needs, time horizons and risk capacity of each individual client goal. Risks are assigned to individual goals and the categories can include other financial products beyond traditional investment portfolios, such as life insurance or long-term care policies as well as annuities. The idea is to clearly link the goal and the solution to help clients better understand how they are progressing on meeting tangible life goals.

Based on this construct, success is first and foremost defined by progress in meeting the essentials bucket goals — what the client absolutely must have. Above-average success is defined as the client achieving the goals within the desires and/or aspirations buckets. As circumstances change, you and the client may make trade-offs within the portfolios and categories. You might reduce the amount set aside to purchase a vacation home so the client can increase money allocated to long-term care needs and so forth.

When we spoke to clients, the

#1

thing they said they wanted *from advisors* **was for them to explain planning and financial products simply** *in a way that doesn't make them feel like he/she is talking* to another financial advisor.

ADVANTAGES OF GOALS-BASED PLANNING

There are obvious advantages to goals-based planning.

First, it changes the way clients think about success in their investment portfolios — shifting the focus from beating a benchmark to reaching their goals. Aligning investments to goals provides sought after clarity to clients, which builds confidence and helps clients feel more secure and less apt to react to every news story.

Second, it forces prioritization of goals — a meaningful exercise that helps clients focus on what really matters, which results in more meaningful conversations.

And finally, with risks tailored to each goal, clients have a better understanding of their risks, helping you set better client expectations and giving you a nice context for discussing how various circumstances might impact the client's plan and goals overall.

So goals-based planning solves a lot of the key problems around creating better context for client/advisor conversations and tempering overly emotional investment decisions. It certainly makes evaluating success more tangible for clients, but it does create more up front work for you. You now have multiple client portfolios to build. This is where outcome-oriented products can help.

According to the Ernst & Young *2014 Wealth Management survey,* **goals-based planning was the most important trend** *influencing where clients invest their assets.*

[4] Source: Casey Quirk, Life After Benchmarks: Retooling Active Asset Management, November, 2013.

OUTCOME-ORIENTED PRODUCTS

Casey Quirk predicts that by 2018, outcome-oriented strategies will represent nearly 45% of industry revenue opportunity worldwide. They believe these strategies will attract $3.4 trillion of inflows during that same time period.[4]

Outcome-oriented products are multi-asset class funds designed to meet specific client needs, such as growth, income or capital preservation, to name a few. Because these funds are not linked to a benchmark but instead to an objective or outcome and are by definition well-diversified multi-asset class solutions, they can easily be used with a goals-based planning approach, making the idea of managing multiple portfolios per client somewhat less daunting.

Because these funds are not constrained to a benchmark, portfolio managers have greater flexibility to employ active or dynamic asset allocation strategies and can take advantage of alpha creating opportunities that traditional funds cannot.

How to Navigate a Low Rate Environment:

Given the extraordinarily low level of interest rates in recent years, institutions (pension funds, endowments, etc.) and retail investors alike have been searching for yield.

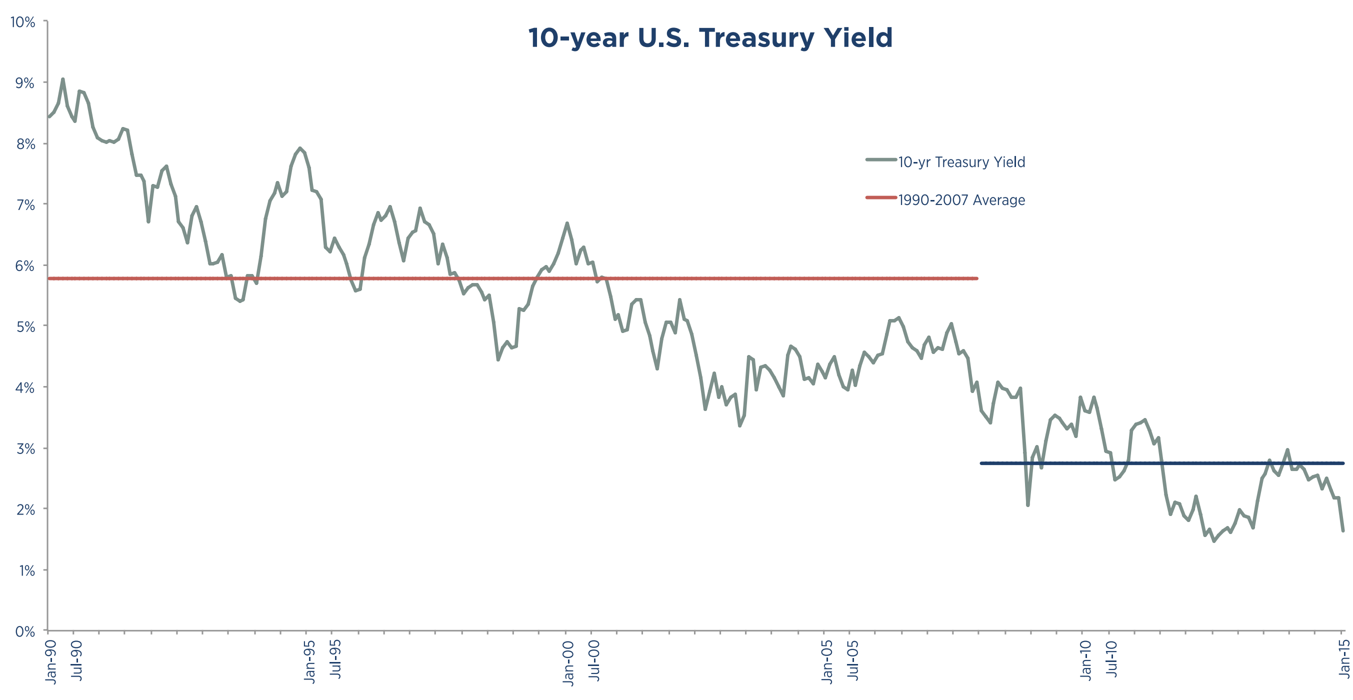
With equity markets near all-time highs and the impending struggles in fixed income as interest rates begin to normalize, this challenge will likely become more pronounced in coming years.

Many institutions have allocated to nontraditional asset classes and alternative investments to diversify returns and boost yields.

Retail investors, however, have been slow to follow due to the perceived complexity and lack of availability of these products.

Outcome-oriented solutions can address client apprehension through a diversified portfolio while providing an institutional quality product to the retail investor.

Figure 4. 10-year U.S. Treasury Yield Jan-1990 through Jan-2015



Source: Factset, 2015

In addition, these funds tend to incorporate more alternative investment asset classes, allowing clients greater market exposure in a more efficient and less complex way. Alternative investments can be an excellent way to bring stability to a portfolio, but often times this can be a difficult conversation because, for investors the word *alternatives* translates into more perceived risk.

With interest rates poised to rise, equities at peak levels and news outlets talking about the "next" recession, clients aren't likely to become less risk averse.

The use of outcome-oriented products with a goals-based planning strategy may prove a very effective way for advisors to provide more value to clients and help restore their confidence.

Today there are a limited number of outcome-oriented products and adoption is slow as advisors continue to evaluate whether the products will live up to expectations. Most rating agencies haven't yet distinguished outcome-oriented strategies as a separate category, so it's sometimes hard to identify and evaluate these funds.

And, as an industry, we've certainly seen some false starts in trying to respond to client needs around changing the client/advisor conversation. At one time it appeared that Managed Payout Funds might prove the solution to moving clients from a focus on "How much did I make?" to "How much do I need to meet my expenses?" With the recession of 2008, most of these funds were unable to deliver on their promise of a targeted distribution amount. But even with those limitations, we suspect that given all that is expected of advisors today, interest in these products and the goals-based planning approach will grow.

While I sometimes miss the simplicity of the days of picking securities and focusing on performance, I have to admit that I envy your opportunity to truly shape your clients' future, in a more profound way than ever before. What an amazing privilege you have to help your clients plan for and live in retirement.

Where managed payout funds went wrong

Managed Payout Funds came on the scene in 2007/2008. The funds targeted a distribution level each year, regardless of the portfolio performance. The level of risk taken in the fund was determined by the level of the payout that was targeted: generally these ranged from 3% to 7%.

The idea was to help clients better understand how to use their money in retirement. It shifted the conversation from 'how much did I make?' to 'how much do I need to meet my expenses?' To a large degree it was the sequence of returns that was probably the biggest downfall for these funds, with many being launched just before the market downturn.

When the Great Recession followed, these funds lost anywhere from 26% to 47%. Some portfolios consisted of just domestic and foreign equities, bonds and cash – a very traditional allocation that lacked the proper risk management aspects to help limit downside risk.

KEY TAKEAWAYS

1 **Break down and simplify**
retirement planning conversations with your clients using a goals-based planning approach.

2 *Consider how you might*
incorporate outcome-oriented products into your clients' portfolios
to align your clients' goals with their investment objectives.

3 **Demonstrate your value add**
to clients by meeting holistic needs and simplifying the retirement planning conversation.

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Important Disclosures

This white paper is for informational purposes only, does not constitute advice, and is not intended and should not be relied upon as an offer or recommendation with respect to the purchase or sale of any security. In addition, this white paper does not consider the specific investment objectives, financial situation and particular needs of any person. Except where otherwise indicated, the views and opinions expressed are those of Nationwide as of the date noted, are subject to change at any time, and may not come to pass.

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