Keep Clients Focused on the Big Financial Picture

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Your clients may never fully understand all the financial products they own. But it's crucial that they grasp the big picture so they buy into the financial plan you've created for them, make smart choices and stick with their investments during tough times.

The trick: Reframe your financial conversations with clients so you get them to look beyond the slew of stocks, bonds and insurance policies that you've helped them buy — and instead think about their money in terms of broad themes.

Here are six major themes to focus on:

1. HUMAN VS. FINANCIAL CAPITAL

If there's one core element around which we should design our financial lives, it's our so-called human capital, which is just a fancy way of describing our income-earning ability. Our human capital — or lack thereof — has four key financial implications.

First, and maybe most important, we need to take part of the earnings from our human capital and use it to amass a heaping pile of financial capital so that, one day, we will no longer need a paycheck and we can retire.

Second, our human capital should drive our asset allocation. A regular paycheck is similar to collecting interest from a bond (though some paychecks are more bond-like than others). When we're younger, the income from our human capital "bond" frees us up to invest heavily in stocks. But as retirement approaches, we need to buy more bonds, so we have interest income to replace the income from our human capital.

Third, our human capital should factor into our borrowing strategy. When we're in our 20s, taking on debt can make sense, because it allows us to smooth out our consumption over our lifetime and we know we have decades of paychecks ahead of us to service these debts. But as we near retirement and the last of our paychecks, we should endeavor to get all debts paid off.

Finally, our human capital helps drive our insurance needs. What happens if we suddenly can't provide our family with a paycheck? That's the reason we may need life and disability insurance, as well as a robust emergency fund.

2. YIELD VS. YEARS OF SPENDING MONEY

It’s one of those hoary financial principles: It’s OK to spend investment income — but we should never, ever dip into capital. The problem is, in a low-yield world, it’s almost impossible for retirees to live solely off investment income unless they have a massive portfolio or they buy dicey high-yielding securities.

What’s the alternative? Get clients to think less about yield — and more about years of income. If stocks plunged and interest rates soared, how long could your retired clients go without selling their stocks and riskier bonds at fire-sale prices? At every meeting, you should tell your retired clients how many years of portfolio withdrawals they have tucked away in cash investments and short-term bonds. You might even ladder CDs or high-quality bonds so your clients know exactly where their income is coming from in each of the next five or 10 years.

3. UPSIDE POTENTIAL VS. DOWNSIDE PROTECTION

What if clients are still in the workforce? Instead of talking about years of income, you might encourage your working-age clients to think of their portfolio in terms of upside potential and downside protection. (Alternatively, you could use the phrases “growth money” and “safe money,” but you should probably lower your voice if somebody from the compliance department is nearby.)

This has two advantages. First, it allows you to better manage your clients’ expectations, by helping them to understand each investment’s role in their portfolio. Second, it’s useful in highlighting the riskiness of different bonds. For instance, short-term Treasuries would be classified as downside protection, while the upside potential bucket might include high-yield junk bonds and emerging-market debt.

4. CERTAINTY VS. UNCERTAINTY

Not all investments fall neatly into the “upside potential” and “downside protection” categories. That’s why you might also talk about degrees of uncertainty. That uncertainty stems partly from the asset class involved. We know stocks involve more uncertainty than bonds, and bonds are more uncertain than cash investments.

But uncertainty also stems from how actively you manage a portfolio. A total stock market index fund has all the uncertainty of the U.S. stock market. But shareholders enjoy relative certainty, knowing they will capture whatever the U.S. market delivers. By contrast, owners of actively managed U.S. stock funds have no such assurance — and the uncertainty is even greater if the manager runs a concentrated portfolio or makes tactical moves in and out of the market.

5. FIXED VS. DISCRETIONARY SPENDING

Got clients with handsome incomes, but who complain that they struggle to save enough and cover the bills? In all likelihood, your clients aren't profligate. Rather, they may have boxed themselves in with high fixed costs, including hefty mortgages, car leases, insurance premiums and monthly payments for phones, cable TV, music streaming and (much) more.

To help your clients understand why money always seems to be tight, get them to divvy up their monthly expenditures between fixed costs and discretionary spending. The latter includes vacations, eating out and going to concerts — the sort of spending that brings us the most happiness. Got a family who is devoting more than 50% of their pretax income to fixed costs? These are the folks who could find themselves in a heap of trouble if they lost their job. You might push them to trim their fixed expenses — and make sure they have an emergency fund equal to six times these fixed monthly living costs.

6. INVESTMENT VS. CONSUMPTION

When we buy an ice cream or an iPhone, we don't kid ourselves: We know we're spending, not investing. But this obvious truth seems less obvious to clients when they remodel their kitchens, buy a new car or purchase an initial public stock offering. Sure, there's a chance that the kitchen will boost our home's value by more than the cost, that the new car will one day be considered a collector's item and that the IPO will outperform the market averages. But the chances are slim.

How can you help clients distinguish true investments from purchases that have an element of consumption? A starting point: Ask clients how much pleasure they get from the new kitchen, the new car and from speculating on stocks — and then explain that the more pleasure they receive, the smaller the monetary gain they're likely to pocket.

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