

Need vs. Want

- By Neil Hantak, CFA®

Need versus want. That fine line between a requirement and a desire. The concept is so simple yet so intricate that we have been taught from an early age how to distinguish between the two. Needs maintain our existence; wants stem from these needs and our innate ambition to improve. However, needs and wants are not necessarily absolute. Location, lifestyle, and personal characteristics play a larger role in differentiating. Someone living in an urban area with viable public transportation may not need a car to get around, in which case owning a car becomes a luxury. Someone living in a rural community may need an automobile to get to and from work. The same distinction between needs and wants should be applied to investing.

Most investors assume successful investing equates to obtaining the biggest returns. The biggest returns are only desires though and may not take into account an investor's actual needs. So then, what return is needed in investing? That starts with the end goal in mind. Defining one's goals and ability to save while realizing one's limits, whether risk or financial restraints, are the first steps in knowing what is needed when investing.

This should be the central piece of conversations with a financial advisor. The best advisors will help their clients understand their specific goals, realistic ability to achieve those goals, opportunities and pitfalls. This process provides detailed objectives and parameters the advisor should use to construct a portfolio tailored to the client's needs. With the goals identified, the advisor can recommend a proper asset allocation taking into consideration the client's timeframe, cash flow and risk tolerance. To answer the original question: the return needed is the one that maximizes the likelihood a client meets his/her objectives while taking the least amount of risk to do so.

However, this is not where the investment discussion should necessarily end. The client/advisor relationship should have helped define a client's ability to take risk. The required return assumes the lowest amount of risk, but a client's risk tolerance may allow him/her to accept more risk as long as it does not greatly decrease the likelihood of meeting his/her goals. This excess risk capacity may provide higher returns allowing clients to not only obtain their goals but to potentially improve upon them. This extra return could fund legacies for heirs, fulfill charitable inclinations or just provide additional flexibility in their daily lives.

Our financial advisors work with our clients to construct portfolios that will achieve their goals with a high degree of certainty and provide opportunities for better returns if their risk tolerances allow. Those that focus only on the highest returns and not on the goals may take unnecessary risks and end up jeopardizing not just their clients' wants, but their needs as well.



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Disclosures:

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