

3 Simple Principles of Financial Decision Making

A successful investor friend of mine recently invited me to hear a well-known tax professional speak on strategies to minimize your tax bill. The presenter spoke for an hour about simple strategies, and then he offered the audience an opportunity to purchase what he described as a “no brainer” strategy. The detailed overview of the program (complete with video footage) seemed fabulous – particularly when he included the added incentive “if we signed up before Friday”.

A Sales Pitch with Information Attached: This situation is repeated over and over again – sometimes in financial terms, sometimes in retail or other similar environments (ever watched an infomercial?). Basically, it’s a sales pitch with some good information attached. This time it was a group setting, but it can also be found in a one-on-one with a financial professional, or even with your neighbor. It could also be offered to you in written or other media format by an unknown third party. These opportunities come up almost every day, but the bottom line is always the same: how do we decide if this is really the answer to our prayers, the road to riches, or simply a sales pitch and someone’s opinion?

Take the Stress Out of Financial Decisions: I am not going to offer an evaluation of this specific opportunity, rather I’ll use it as an example to help you take the stress out of making financial decisions. I originally developed these principles while working with securities regulators to update their program on avoiding investment fraud. They are: KNOW YOURSELF; KNOW YOUR ADVISOR; and KNOW YOUR INVESTMENT.

Know Yourself: Your most important decision making criteria is to understand your motivation for being interested in the first place. What do you expect to learn? What are your hopes, desires and incentives that you want this strategy to address? You must know what you expect, and then you must know why you have that expectation!

I went to this presentation because I am looking for ways to save tax; because I am always on the lookout for different and creative financial strategies; because I respect my friend’s position as a professional investor and wanted to learn more about something he believed in; and I wanted to hear the speaker. My motivation was simple: I really, really, really don’t want to end up with a big tax bill this year. Also, in my profession, I am frequently asked about different investment strategies – not just ones that I recommend, but others that are available in the marketplace. I feel I have a professional responsibility to learn what I can about what’s available – good or bad.

Know Your Advisor: The next check point in making financial decisions is to learn about the person making the offer to you: How do they get paid? What is their background? What is their expertise and experience? How well do they know you, your goals, your situation and your background?

In my example, I knew of the speaker and my friend is someone I can talk with openly about our personal finances. He has a strong investment background and I am a professional advisor. But, if my husband and I had gone by ourselves, then we would have wanted to ask someone else what they thought of the strategy for us, and if our advisor wasn’t at the meeting or had no previous experience with this type of program, then we would be left on our own to make the decision or left to interpret his opinion of the strategy and our goals.

Know Your Investment: Finally, the financial decision process moves to the specific investment or strategy itself. This is always where people get bogged down because they focus on one aspect of the program: usually rate of return or tax. This is where presenters can bring emotional elements into the discussion. Yes, we all know that a higher return is better than a lower one, and less tax is better than more, but... there are many more important considerations to make first!!! The return and tax aspects become important only after everything else is in place. First, consider your overall investment philosophy, what the product is, what your exit strategy will be and how long you plan to hold the investment.

Not Every Solution Will Work for You: For us, the strategy could work with our situation, goals and experience. However, many people who attended the meeting likely felt that this was something they “should” do, but weren’t sure. There would also have been people there who decided to participate in the program because they were caught up in the excitement without being fully aware of all the details. The presenter used smooth presentation skills to convey the strategy, and given the circumstances, he could have raised some red flags for people hearing the message for the first time. He certainly created a feeling of pressure to act right away, emphasized the great tax advantages, and introduced a concept that would be new and different for most people.

Remember to Do Your Homework: That doesn’t mean that the strategy or investment is automatically bad, it simply means you have to do some homework before you make your decision. In fact, the sort of due diligence that you would perform in making a decision to participate in something new is really the same criteria you need to consider in all financial decisions. It is so easy to get complacent and comfortable with the same message, and therefore, forge ahead because it is familiar – not necessarily because it is right, good or even appropriate – only because it is familiar.

Be Aware of Your Emotions: The point to this example is to learn to become aware of your emotions when making decisions. There are many simple, practical strategies that can be used to make logical, sound, strategic financial decisions. When you take out your emotions and put it some “real” criteria, then you can make decisions confidently and be in a position to take advantage of opportunities that can really make a difference in your financial life!!

You can learn how to make profitable financial decisions, and as your knowledge increases, so will the opportunities. Start with the knowledge you have and make a commitment to learn. There are many resources available – the alternative is to continue to second guess your decisions or struggle financially when it absolutely isn’t necessary!!

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