Morningstar Behavioral
Science Research

When More Is Less
Rethinking Financial Health

Sarah Newcomb, Ph.D.
Behavior Economist
Morningstar

We draw on results from a survey of U.S. adults to create a model of financial health. Using demographic, psychographic, emotional, and behavioral variables, we show that financial behavior and emotional well-being are affected by two simple mental factors that advisors can target to better help their clients achieve financial health.

Financial health includes both economic and emotional dimensions
Focus groups with financial advisors revealed several themes of financial ill-health among clients and showed the need to incorporate emotional well-being into our definition of financial health.

Time is money
The further ahead a person thinks in time and the clearer their picture of the future, the better their behavior in terms of cash, credit, and savings management. This relationship remains significant when controlling for income, age, and all other demographic factors.

Power is happiness
Across all income levels, people who believe they create their own financial destiny experience, on average, more positive emotions with respect to money, than those who believe they have less power.

Financial Wellness

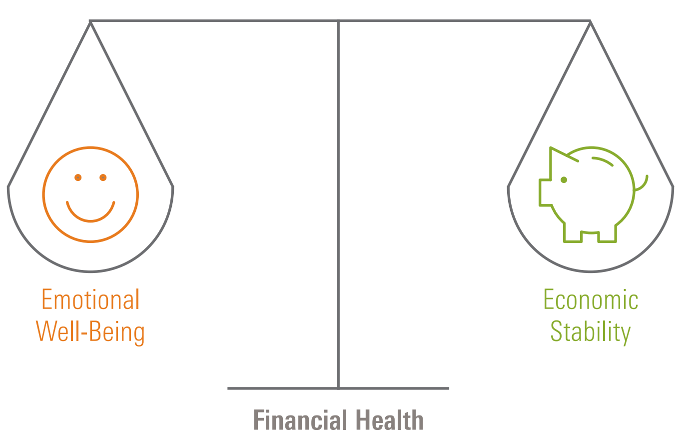
Every advisor has met them: the clients who will never outlive their money yet are so afraid of not having enough that they cannot buy a gift for their grandchild without anxiety. A standard financial algorithm would classify these clients as being in excellent financial health, since they possess enough material wealth to withstand any reasonable economic shock—yet their quality of life is quite low. They do not have peace of mind.

Traditional definitions of financial wellness focus on the economic aspects of a person's life. This is essential, of course, but it neglects how a person feels about their financial circumstances. A finance-only definition of well-being assumes that emotional well-being will automatically follow economic stability—our research at Morningstar shows otherwise.

Throughout 2016, Morningstar conducted several focus groups with financial advisors to learn about the types of financial ill-health they encounter in their day-to-day practices. In every session, similar themes emerged. There are the clients who fear not having enough, despite every indication to the contrary. There are those who are so fearful of making a wrong choice that they refuse to make any, leaving their wealth to slowly erode in cash accounts. Other clients, in contrast, spend too freely, choosing blissful ignorance about the damage done to their bottom line.

The lesson from these interviews was clear: Our current measures of financial well-being are flawed. If we ignore the emotional aspects of clients' financial lives, we do them a great disservice. The fearful penny-pincher may be wealthy, but they are not well. Likewise, the blissful spendthrift may be joyful, but the instability of their economic state could easily lead to ruin. Financial wellness, then must be defined in a way that includes economic and emotional health.

Based on these interviews, Morningstar has developed a simple model of financial health that incorporates both the economic and the emotional aspects of well-being. According to this model, a person who isn't both economically sound and emotionally well, is not financially healthy. Advisors can use this framework to quickly identify the specific aspects of a client's financial health that need to be addressed, and use this information to guide them toward greater well-being.



Making It Practical

To put this model to practical use, we need to know what factors drive economic stability and emotional well-being so that advisors can work directly with the source of each dimension of financial health.

The remainder of this paper outlines two simple components of psychology that are associated with economic stability and emotional well-being. This information will help advisors target the specific area(s) where their clients need the most support and use simple tools to improve the client's underlying financial psychology.

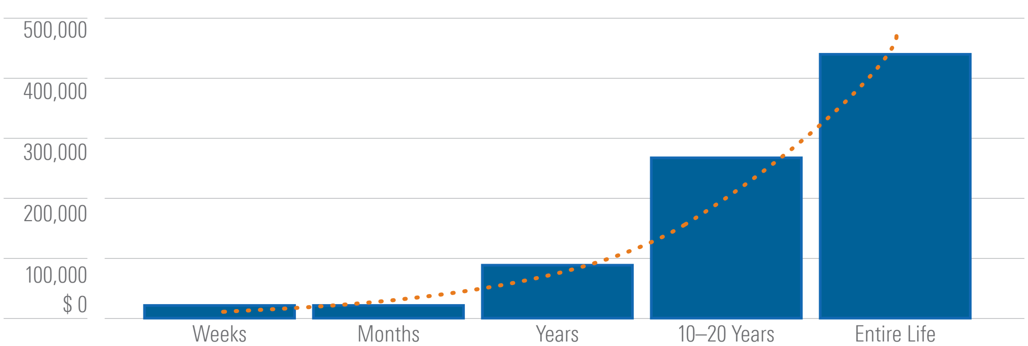
Economic Stability: Time Is Money (but not like you think)

What factors motivate better cash-management, debt-reduction, and savings behaviors? In a survey of several hundred U.S. residents, we found that a person's perspective on time was far more influential than income, age, education, or gender when it came personal finances. Our results showed that people who think further into the future tend to save more frequently and build larger savings balances in retirement and nonretirement accounts.

Compared with those with time horizons of less than a year, people with full financial life plans had, on average, 20 times more money saved. Even looking ahead by just a few years increased savings fourfold. Regression analysis showed that the effect of time horizon on retirement savings was significant even when we controlled for age, income, gender, education, and the number of dependents, and the size of the standardized effect size was greater than that of the demographic variables. In other words, life circumstances matter some, but perspective matters more.

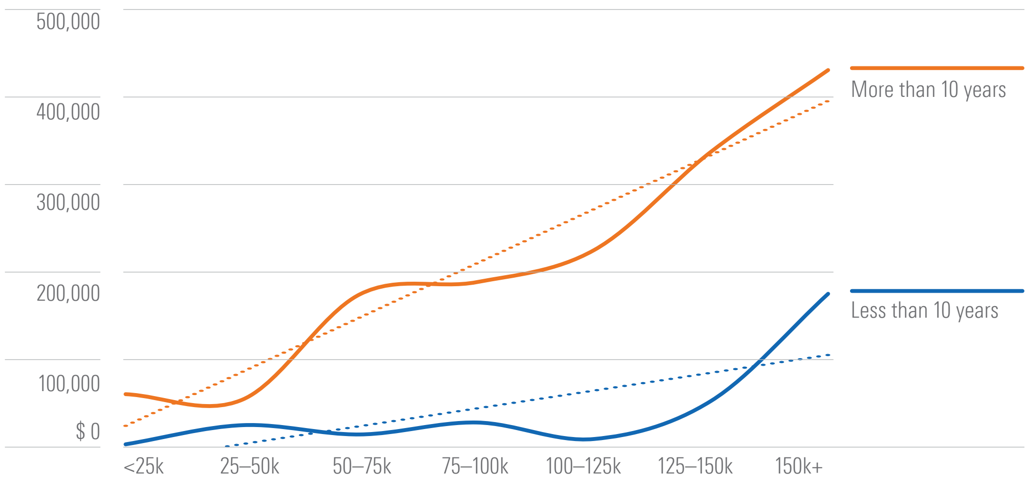
Our analyses showed time horizon had a significantly greater impact on economic behaviors than income. Yes, a person must have income that is adequate to their needs if they are going to be able to save. Our study suggests, however, that regardless of paycheck size, having a future-oriented mindset can make the difference between allowing expenses to crowd out one's income or finding ways to save money.

Average reported retirement savings by mental time horizon



As the graph illustrates, in every income group, people who think further ahead (orange line) saved more than those with shorter time horizons (blue line). Again, it's important to mention that the effect is significant when controlling for age, income, gender, and education levels.

Retirement savings by income and mental time horizon



Mental time horizon was correlated with more than just savings behavior; it had the same effect in reported cash and debt-management. This suggests that people who think ahead are more likely to keep track of spending, pay their bills on time, and carry low or zero balances on their credit cards. These effects also remained significant when controlling for demographic factors.

Clearly, (mental) time is money.

Getting Clients in the Habit of Thinking Long-Term

The difficult truth is that our brains are hard-wired to give more weight to immediate needs, and to discount the future. Some people naturally think further ahead than others, and our mental time horizon does tend to extend with age. Still, most people don't think nearly far enough ahead to naturally motivate the kind of saving that will adequately prepare them for retirement.
The shorter a person's mental time horizon, the more they will find long-term saving to be a challenging and painful task. The good news is we can train our thoughts and form new habits over time.

Tools for Initial Assessment—Identifying Clients' Mental Time Horizon

As an advisor, you are in an excellent position to help clients improve their mental time horizon. Onboarding interviews offer an ideal opportunity to determine a client's current mental time horizon, and periodic check-ins provide the platform for moving their vision outward over time. Since it fits easily into conversations about financial goals, this process can be very simple and natural. Here, we offer a few tips to help in the process.

In your goals discussions, make sure to include specific time markers in your questions.

Start with the short-term (where would you like to be, financially, in a year?) and then extend outward (five years, 10 years, 20 years). When recording their answers, make sure to listen for the following:

- How clear and detailed is their vision? Do they use general, abstract words, or do they describe specific scenarios and milestones?
- At what time horizon do they shift from specific goals to vague ones? This indicates a shift in their ability to see clearly at that time distance.

We tend to use specific terms and concrete details when talking about things we can picture clearly. When our mental picture gets fuzzy, our words shift to the abstract. For example, a person who has a vague mental picture of their retirement may describe their goals as follows:

I want to be financially secure.

I want to have peace of mind.

I just want to relax and enjoy myself.

On the other hand, someone who sees their retirement clearly will use more specifics, such as:

I want to live in an upscale retirement community near a golf course.

I want to have at least 5 million in assets, not including my home.

I want to travel to see my children and grandchildren at least twice a year, and I want to treat my family to a Disney vacation at least once before the grandkids are too old to enjoy it.

The more detail and clarity a person has in their mental picture, the more clearly they can "see" it in their minds. If a client cannot tell you clearly—using specific details—where they would like to be financially by next year ("I want to have zero credit card debt, a new car, and be putting 15% toward retirement"), then you are likely dealing with a short-term thinker.

Helping them extend their mental time horizons could dramatically change their financial behaviors, but the habit of thinking ahead will take time to build.

Tools for Extending Mental Time Horizon

When you have short-term thinking clients, the process of changing their time horizon can take time. In your initial meeting, you'll identify how far ahead they naturally think and plan, next, work on extending their mental time horizon. This can be as simple as having them do a writing or thinking exercise that walks them through a full day in their life just beyond their current time horizon. You may also encourage them to use entertaining tools like age-progression of a photo in order to help them "see" their future self. Anything that puts detail and clarity into their picture of the future should help them to extend their time horizon.

In your check-in meetings, make it a point to ask the time horizon questions again. Listen for the following:

- Have they become more comfortable talking about future details?
- Has the time horizon where their vision gets blurry changed?

If a client is accustomed to thinking very short-term, trying to push their view out 30 years may be unrealistic. Do they only think about the next six months? Then make it your goal to help them form a detailed one-year plan by your annual review. Do they think a year or two ahead? Challenge them to write about a day in their life 10 years from now by your next meeting. Writing on their own time can help clients refine their goals and pinpoint their priorities, which also helps set realistic numerical expectations for life after retirement.

The important thing to remember with visualization exercises is detail. In our research, we saw that the clarity of a person's mental picture had a large impact on behavior—almost as much as time horizon. The combination of thinking further ahead and thinking with clarity, is a powerful mental trick to drive better savings behaviors. While it may seem simplistic, this one mental factor can affect thousands of tiny daily decisions, and it may be the difference between a timely, secure retirement and a delayed, precarious one.

Emotional Well-Being: Empowerment Is the Key

According to the American Psychological Association, year over year, money is the number one source of stress in U.S. households, regardless of the economic climate. Given that stress leads to health problems, lost productivity, relationship problems, and an overall loss in quality of life, it's clear that the emotional aspects of a person's financial life are a critical part of their overall financial health.

Ideally, economic stability would naturally couple with emotional well-being, since the ability to withstand shocks should foster a sense of peace and satisfaction. However, advisors know first-hand that emotional satisfaction and financial wealth aren't always linked.

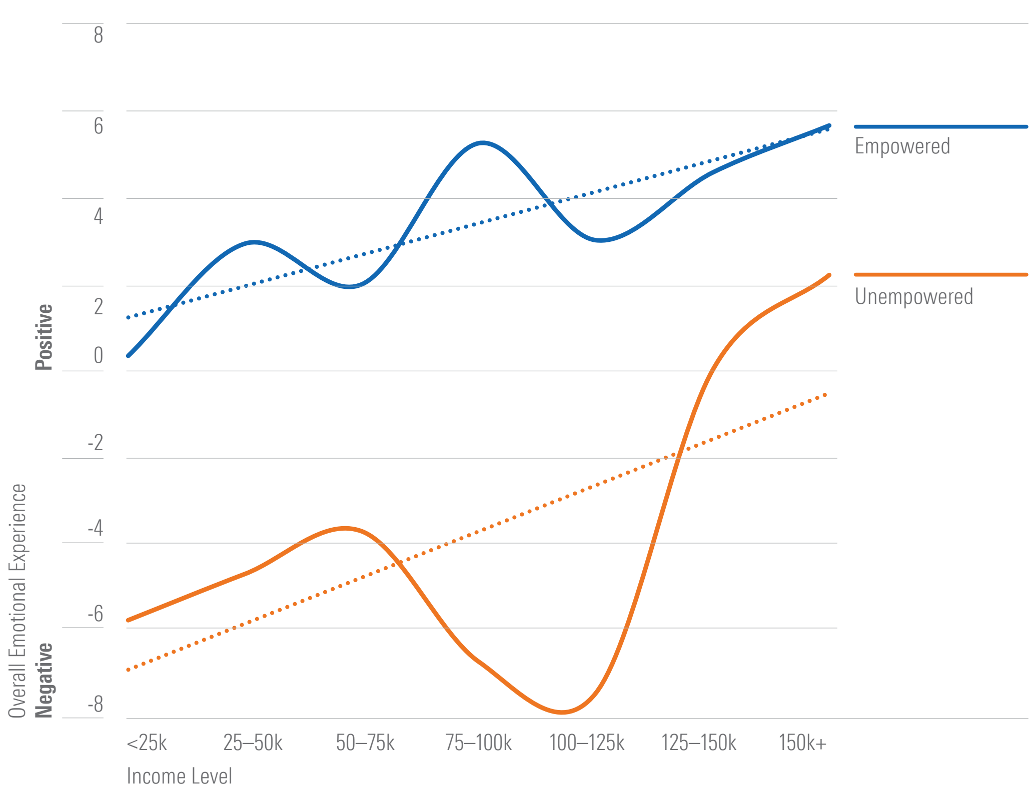
This area of financial health is not well studied and there are few—if any—existing measures. Emotional and attitudinal factors present an opportunity for advisors to coach their clients in a very meaningful way. By identifying specific patterns of thought that may sabotage a client's overall financial health, an advisor can help guide clients into making better financial decisions and increase their satisfaction and peace of mind.

In our study, we found that—across all income groups—people who feel empowered in their financial lives experienced more joy, peace, satisfaction, and pride in their financial lives. Like time horizon, this effect remained significant when controlling for age, income, education, and gender. The standardized effect size of empowerment on emotional wellbeing was more than twice as large as that of income.

In the graph, the blue line represents people who agreed with the statement: "I create my own financial destiny." The orange line represents people who said instead that they: "Have very little power" in their financial lives. As displayed above, people who feel empowered had mostly positive experiences with respect to their money, even in the lowest income ranges. Those who felt disempowered were, overall, less happy than their peers, and didn't reach the positive range until their annual earnings were well above $100,000.

The lesson here is fascinating: A sense of personal power—not money itself—may be the key to emotional well-being in our financial lives.

Emotional well-being by income and empowerment



How Advisors Can Help Their Clients Think This way

Some people have less influence over their financial decisions than others, such as dependents, non-involved spouses, and those who live on the income from trust funds. Still, even if a person is not involved in earning or makes few spending decisions, there are very few people who truly have no control over their finances.

Even non-earners often have much more control over their financial life than they think. Are they the shopper for their household? Do they participate in decisions about vacations, living costs, children's schooling, etc.? Are they a source of emotional and moral support for the breadwinner? These are all areas where power is manifest in one's financial life.

Tools for Increasing Empowerment Over Time

In our study, we did not measure how much control a person actually had in their financial lives, but how much they believed they had. It is the feeling of power, not necessarily the exercise of it, that we found was linked to emotional well-being. Therefore, the solution to feeling disempowered doesn't necessarily lie in behaving differently, but in a person's belief that they can shape their financial future.

Helping clients recognize where they do have power and encouraging them to take ownership of past decisions, can go a long way toward bringing their feeling of control inward.

A person's belief about power in their lives, financially or otherwise, may be harder to change than their time horizon. Still, there are tools you can use to help willing clients move toward empowerment and improve their emotional well-being.

Involve them. While some clients have a "do it for me" approach to financial matters, make sure to explain that true financial health requires their involvement. They need to know that, with your help and coaching, they can make good decisions and reach their goals.

Couples: Many advisors complain that couples often have one active and one apathetic partner. Others require that both parties be present at meetings as a condition for working with a couple. Our work suggests that if either party feels disempowered, it will affect their financial health and possibly strain their relationship.

Help them keep score. If you have a client who is particularly fearful or reluctant to make decisions, you are probably dealing with a disempowered individual. Maybe they haven't forgiven themselves for a mistake made years ago that cost them a fortune. Maybe they don't trust themselves to make good choices, or they simply don't want to fail. In any case, helping them see the effect of past choices and encouraging them to celebrate their steps toward stability can help empower them to get more involved.

Don't be patronizing. Nobody wants to feel talked down to. Still, you can help a person who feels powerless to see where their decisions have effected their finances (even if all they've done is contribute to a 401(k), or walk into your office, they've chosen to do something).

Conclusion

Financial advisors play an important role in guiding clients on the path to financial health. We argue that people need both economic stability and emotional well-being to be financially healthy, and utilizing two simple principles from psychology can contribute to both factors.

Advisors can use this information to assess how healthy their clients are by adding two simple ideas to onboarding interviews and check-in conversations. By helping clients think further into the future and feel more personally empowered in their financial lives, advisors can foster positive changes in clients' economic behaviors and emotional well-being over time.

Recommended Reading

LOADED: Money, Psychology, and How to Get Ahead without Leaving Your Values Behind

by Sarah Newcomb

In 2016, Morningstar released a book on personal finance and psychology for the layperson called *LOADED*. Its purpose was to:

- Reveal unhealthy attitudes and beliefs that lead to financial self-sabotage
- Teach a cash-management technique specifically designed to bring one's sense of power inward.

Financial empowerment is a deeply-rooted mindset that clients may need time and help to develop. The personal economy concept laid out in *LOADED* was developed for the purpose of helping move individuals from a sense of powerlessness to one of personal control, responsibility, and empowerment While we recommend a full reading of the personal economy chapter of *LOADED*, a simplified version of the personal economy concept is also available for free download as part of our Simple But Not Easy behavioral toolkit for advisors.

Find out how Morningstar helps advisors

Call **+1 800 886-9324**
Email **advisorsolutions@morningstar.com**
Visit **global.morningstar.com/Advisors**