Heart Attack or Hangnail

If you go to see your doctor with a medical issue, the medical professionals will ask a series of questions and may run a sequence of tests to determine a diagnosis and recommend proper treatment. One would expect a doctor to prescribe a completely different regimen for a patient if he was having a heart attack versus if he had a hangnail. The same is true in the financial services profession.

The financial service industry is highly regulated and for good reason. Financial services industry rules require Financial Advisors to “know your customer”. This includes basic information such as name, address, and employment status.

In establishing an account with a Financial Advisor, additional factual information needs to be determined in order to comply with these industry rules. This includes documentation of the client’s financial situation including annual income, net worth, liquid net worth and the account value. Additionally, tax status, investment experience, time horizon and liquidity needs are important facts a financial professional must determine in order to make a suitable recommendation to the client.

Assessing one’s investment objective and risk tolerance is also important. This can be more challenging to determine versus simple facts such as employment status. Financial advisors are trained to ask appropriate questions to gain an understanding of a client’s investment objective and risk profile. Tools such as risk profile questionnaires may be used to additionally determine this information. Like pain, the definition of risk can vary from one person to the next and one’s willingness to engage in risk may evolve over time.

Determining one’s investment objective and risk tolerance is paramount to determine an appropriate investment recommendation. For example, a client with a short-term time horizon, a high sense of urgency, and a low risk tolerance should not be prescribed an aggressive investment that is illiquid for a long period of time. In that situation, a savings account, money market, or short-term certificate of deposit would be a reasonable option.

Relationships are a two-way street. On one hand, it is the Financial Advisor’s responsibility to gain an understanding of the client’s financial situation and goals, and it is the client’s job to share concerns, questions, relevant experiences, and be open and honest about their situation and objectives moving forward. A more complete understanding of the underlying facts and situation will increase the probability of a correct diagnosis and path of treatment.

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