What you can learn from institutional investors

A well-designed plan allows the biggest investors to calmly handle uncertainty and volatility.

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Key takeaways

- Research shows that investors who are motivated by a clear and inspiring mission are more likely to outperform their peers.
- Having a documented investment plan that articulates your goals, risk tolerance, and personal values can help you stay the course in times of uncertainty or volatility.
- It's important to stay in close contact with your financial consultant to make sure they're aware of any changes in your financial or family circumstances.

Institutional investors, such as hedge funds, endowments, and family offices, are responsible for managing billions of dollars on behalf of the wealthiest families and organizations in the world. Their decisions can move markets, and they take great pains to stay focused on long-term goals and avoid overreacting to market volatility or the vagaries of the news cycle. While institutional investors often have access to resources and expertise that aren't available to most individual investors, what really helps them navigate uncertainty is something that anyone can take advantage of—a clear sense of purpose.

According to a 2020 McKinsey study, institutional investors that have a clear and inspiring mission that informs their decision-making are more likely to outperform their peers. And the way many institutional investors express that mission and ensure that decisions are made with it in mind is by drafting what's called an investment policy statement (IPS).

The investment policy statement is a document that clearly articulates what the institution's ultimate aims are and what they consider to be acceptable or unacceptable outcomes. It provides a framework through which an institution can effectively respond—or not respond—to unexpected shifts in the market environment.

For an individual investor like you, putting your thoughts down on paper can help clarify your needs and goals, set objective guidelines for risk, and provide a gut check when uncertainty in the market shakes your confidence. At Fidelity, clients who own a managed account begin by filling out a goal-planning questionnaire that includes many of these questions, which helps their advisors build an allocation that suits their needs. "It's always a good idea to think through and document your intentions before sitting down with a financial consultant," says Andrey Lyalko, vice president, investment advice at Fidelity Investments. "It will help you sort through the decisions and tradeoffs required to draft a plan and make for easier, more productive discussions about your wealth."

Be clear about what motivates you

A good place to start is with a clear and unambiguous statement of purpose. It should be about more than just making money—it should express the deeper hopes and aspirations that your wealth can unlock for you and your family: a comfortable retirement, debt-free education, future entrepreneurship, philanthropy, or anything else that inspires you.

Supporting your statement of purpose with a narrative about how you earned your wealth, the sacrifices required, and the hard work it entailed, can have a significant impact as well. This provides important context for your financial professionals and for family members who may not have the same emotional connection to the wealth that you do. It may also serve to remind you of your own responsibility as a steward of the wealth—taking a long view into the past, as well as the future, can make the challenges of the present seem less daunting.

"While these might not be things your financial consultant will use to recommend an investment strategy, they can be very useful in helping investors determine the answers to difficult questions, such as your risk tolerance or the importance of a certain goal relative to another," says Lyalko. "Understanding the history and meaning behind the money and sharing it with your family can provide some much-needed perspective, and make sure that all the parties are aligned on how to approach future decisions."

Articulate your long-term goals—and your short-term needs

Think broadly about your investment objectives. Identify your top priority when it comes to investing—are you seeking to grow your portfolio, to generate income, or to protect your assets? Then, get specific. What is the reason behind that broad investment objective? Perhaps you are prioritizing growth because you want to support a long-term, philanthropic legacy that has the means to support your favorite causes well into the future. Maybe income generation is important to you because you are concerned about being able to maintain your current lifestyle in your retirement and are looking to gain the peace of mind that comes with a steady flow of cash. Whatever your thinking might be, clearly articulating your objectives is an important step in devising a goal-based investment strategy that can withstand short-term volatility.

While much of this exercise is forward-looking, it's important not to overlook the here and now, especially when it comes to spending. You should understand your spending needs and think about the difference between your essential spending and more aspirational or discretionary spending. This will help you and your consultant develop a spending policy that calculates how much you can draw from your portfolio without undermining its growth potential or eroding its principal. Start simple, by laying out what you expect to need to cover your annual expenses and work with your financial professional to develop a more comprehensive figure that factors in return assumptions, taxes, and other considerations.

Get specific about risk

All investing involves risk, but how much risk an investor is willing to take on depends on their unique circumstances. Be honest with yourself—how much of a loss could you handle before you felt like you were in danger of not reaching your goal? Perhaps more importantly, how much of a loss do you think you could tolerate before you end up making a snap decision you might later regret? Put a number down on paper. This will help your consultant balance your financial ability to take on risk with your personal preference for risk in your portfolio.

With a clearer sense of your goals, intentions, and concerns, your financial professional can help you devise and document an appropriate asset allocation as well as a tax-sensitive investment strategy to help you invest in the asset classes and accounts that best suit your objectives and risk tolerance. And knowing that your specific investment choices are underpinned by a strategy that is sensitive to your particular situation will leave you more confident in your portfolio's resilience when times get tough.

Keep your plan up to date

Ultimately, what you've put together is not a legal document or contract. It's only effective if you commit to abiding by it. It's important to review your plan regularly, perhaps quarterly or semiannually, to ensure that your investment performance is satisfactory, and your allocations are still appropriate based on what is laid out in the document.

It's also an opportunity to review whether your objectives and needs have remained the same or whether circumstances require you to update your plan. "Certain life events might require a shift to your strategy," says Lyalko, "Perhaps you've discovered that you need to spend more than you thought to take care of a loved one, or maybe you're getting closer to one of your goals and need to start thinking about cash flow." Lyalko recommends staying in close contact with your financial consultant, making sure they're aware of any changes in your financial or family circumstances that may require a change in approach.

As you begin to write out your plan, you may find it difficult to answer some of the key questions about your goals and intentions. While you may find this discouraging, it's not a reason to abandon the effort. In fact, it's an indication that you need to put serious thought into your investment strategy before it's too late.

Getting clarity around your investing: Key questions to ask yourself

Here are some important questions to consider when writing out your plan:

- Why are you investing? For what purpose?
- Who are you investing for?
- What do you worry about financially?
- Do you anticipate any specific needs or challenges, such as having to care for a loved one?
- How did you and your family build your wealth?
- What did you learn about investing from your parents? How does that inform how you approach investing today?
- How have you reacted when markets are volatile or declining? Were you satisfied with the results of your actions?
- What are your sources of income? Do you expect them to change?
- How much are you spending? How much of that spending is essential? What could you stand to cut back on?

Next steps to consider

Start a conversation

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1. "Why healthy institutional investors outperform," McKinsey & Company, September 2, 2020.