

Considering the universe of financial choice

Greg Lindsay: Over the last decade, a growing number of Americans have taken control of their finances, whether by using fintech tools to get on top of their daily spending or using low-cost investment platforms and wealth management services to start investing.

As the financial universe has grown, new sources of advice have emerged to help guide individuals across it. The most sophisticated advice can pull people away from rash decisions and help navigate the changing economic landscape. But as we shall see, bad advice can lead to trouble.

In this three-part-podcast, we will be travelling across America's universe of financial choice; asking how people can make better decisions, who they should speak to, and how they can take control of their finances.

This is a Vanguard podcast, produced by EI Studios. I'm Greg Lindsay.

So what does America's universe of financial choice look like?

Today, the ratio of stock to other financial assets is at all-time highs, with US households allocating more of their assets to stocks in 2020 than at any time on record. When people talk about the "democratization" of finance, this is what they mean. The markets that were once only accessible to the wealthy are now open to everyone, and investors are flooding in. Over a million Americans opened brokerage accounts for the first time last year. So what's led to such a rapid expansion of America's financial universe?

Ryan Barrows: I always start for American investors with the defined benefit to defined contribution shift.

Greg Lindsay: Ryan Barrows is Vanguard's Head of Registered Investment Advisors.

Ryan Barrows: Those words may not be familiar to everyone, but it basically means a pension where the company used to say, we're gonna pay you X every month when you retire versus one where you save yourself. And you're responsible for your own investments. That's a huge shift for most folks, because that puts the onus of their retirement on them.

Greg Lindsay: An obscure starting point for the modern financial universe, perhaps. But it marks a shift in the control of America's investments and retirement savings.

In 1975, there were only 11.2 million participants in Private Sector Defined Contribution plans: three times that many ceded control of their retirement savings to an employer through Defined Benefit Plans. To the majority, a pension was still an employee benefit, earned through service to a company, not something that they controlled.

Today more than 85 million Americans participate in private-sector defined contribution plans, making their own decisions about how much to save for retirement and how best to do it. New technologies have given people greater oversight and control of their finances without forcing them to stand-in-line at the local bank; services that make it easier to find the right house, pay for your education, or start your own business have emerged, while new systems of credit make it easier to structure your life. But in some areas, the open access these technologies provide can come with trade-offs.

Janelle McDonald: One of the trends... is just the rise of debt.

Greg Lindsay: Janelle McDonald is Head of Strategy & Practice Management for Personal Advisor Services at Vanguard.

Janelle McDonald: That's one we hear about quite often, right? And it may be student loan debt, it may be mortgage debt, revolving credit debt, and, and we really like to try to break that apart. Because not all debt is made the same, right? If you're taking out student loan debt, you're investing in your future earning potential. That is, that's very different. If you're, if you're taking out a mortgage, you're investing in real estate property, something that might appreciate over time, and we'd like to think about those differently than we do revolving credit and credit card debt and things like that. So it is a concerning trend... because you do have a lot more people entering the workforce with higher and higher debt each year. And that's something we have to manage too.

Greg Lindsay: But managing it is becoming increasingly difficult. Between 2016 and 2020, the proportion of payments being made using credit rose from 18% to 24%.

Debt is rapidly outpacing the standards of financial education.

Greg Lindsay: As the universe has grown, new rules have been introduced around how Americans spend, invest, and save their money.

Ryan Barrows: The tax code has become more complicated over time. So the addition of things like Roth IRAs and Roth conversions make it really difficult to save in a tax optimal way unless you enjoy reading the IRS tax code.

Greg Lindsay: To be fair, a lot of these new rules and regulations have developed as a way to protect citizens from risky or harmful financial choices, but the effect can be overwhelming. As the complexity of our choices and the rules governing them has increased, so has the discussion around them.

Kara Perez: I'm very excited about the rise of talking about money on social media and how Gen Z especially in Millennials don't see talking about money as taboo, the way that our parents did, and how that is breaking a lot of barriers, especially in a lot of communities that traditionally have been very financially marginalized.

Greg Lindsay: That's Kara Perez, founder of Bravely Go, an influencer who turned her own finances around and now helps others do the same.

Kara Perez: The two biggest things that pushed me to start a financial education company, is that I was the brokest person in my life...I had gone to a fancy college and met all of these people who come from pretty significant generational wealth...I found myself caught between this world of the kids of the '1%' [elites] in there, while my roommate and I can't do a lot of the things they do because they have all of these safety nets. I started looking for people in the professional finance world who have my background and every other blog that I saw, or all the articles that were being featured on Forbes or CNBC or something it's always like woman leaves her six figure job like women leaves Wall Street to go start financial education company and I'm like, I'm a caterer in Austin, Texas, making \$13 an hour. The idea of six figures was so unreal to me that I decided to start writing for people like me who were like, Okay, I need someone who can talk about what it's like to work multiple jobs, I need someone who can talk about what it's like to struggle with transportation. I was frustrated with how many people in the world of finance were not creating tools for people like me and how common my story is.

Greg Lindsay: For Ms Perez, the rise of social media has been essential in pulling swathes of the American population into the financial universe. But it has also given rise to new questions: Is the advice right for my financial situation? And how do I find advice that I can trust?

Getting advice and support on your finances is important. A recent study by Economist Impact found that the most confident investors were also statistically more likely to seek financial advice. But where did they find it? The same survey found that more than half of respondents were worried about finding a reliable source of financial advice.

This is understandable. The internet is a fantastic resource, but our financial situations are unique. When facing a decision like taking out a mortgage, leaving a job, or starting a family, you need to be armed with more than general information. This makes personalized financial advice particularly valuable, and explains why the number of people seeking professional opinion is higher than ever before.

Ryan Barrows: The question of how can an advisor help always lands a little funny with me because no one ever says, How could a doctor help? You shouldn't feel bad about needing help with your finances, I certainly don't feel bad about asking my doctor what I should do about the pain in my knee. I think that's really the thing to keep in mind. It's okay, and an advisor can help you both with logical things I mentioned first, but also the emotional side of investing... healthcare and money are the two most emotional topics in people's lives in my opinion and so it is hard, right? When you're thinking about when the markets are down 40% what am I going to do? Like, am I going to be okay, or am I still going to be able to send my kids to college like am I going to be able to pay for that wedding? Can I afford my mortgage? Those types of questions like having someone to talk to who's a real professional can be a help for a lot of folks.

Janelle McDonald: It's important to know that you don't have to understand every single choice and trend yourself. You don't have to go at it alone or fly solo. If you really think about it, people are living their lives. And we at Vanguard talk about how people don't always have the time, willingness or ability to go at it alone and get it right every time, right. I'm a mom of three so I can relate to this. People are working their jobs, not always in financial services like myself, so they're often spending a lot of time on other things and don't necessarily have the capabilities or the knowledge to manage their finances well themselves. They may be like me and busy with kids on the weekends. They may be caring for ageing parents, they may be just having fun with their friends, but they're off living their lives. They don't necessarily have the time or the willingness to make the time, even if they do have that knowledge to manage their finances themselves. And that's really where a financial advisor comes in....it can play an important role in helping to make sure that you feel comfortable in managing your wealth and helping you to really come up with a plan that can achieve better outcomes over the long run.

Greg Lindsay: Reaching your financial goals takes the best part of a lifetime, so feeling comfortable on the journey is going to be pretty important. This is particularly true for younger generations, who can face significant financial turbulence in the early part of their journeys. To guide them, we first need to understand the macro-trends at play.

Rakesh Kocharr: One of the puzzles people don't have the answer to is why mobility in the U.S. has decreased. It has been on a steady decrease slow but steady for the last two decades.

Greg Lindsay: Rakesh Kocharr is a senior researcher at The Pew Research Centre, and he's been observing a slow decline in socio-economic mobility amongst younger generations.

Rakesh Kocharr: There is evidence that younger people, compared with younger adults from 30/40 years ago, are less likely to be homeowners. Some of this could be affordability. Some of this could be generational, we do see that there is a greater likelihood of people today to live in multi-generational households. By that we mean somebody older than 25 still living with their parents. And that share has been rising steadily for the last few decades in the United States. Some of it may be because homes are less affordable, some of it appears to be connected to social cultural norms. There's also been the impact of immigration. Asians and Hispanics, for example, are much more likely to be multi-generational households than other households. Some of it could be a reversal in history. We are talking about an increase in the share of that level as multi-generational families but they are returning to a norm that existed before the World War.

Greg Lindsay: Indeed the supply of available housing reached historic lows in the first half of 2021, widening the gap between people who own a home and those still to buy. But coronavirus can't take all the credit for this economic disruption. Nicole Bachaud, analyst at the online real estate marketplace, Zillow, believes we need to travel further back in time to get the whole picture

Nicole Bachaud: After the end of the financial crisis, we saw home builders start building at the same levels that they were building beforehand. Real estate was seen as a little bit of a riskier investment at the time and so we didn't see a lot of focus on adding new supply to the market in the same way we had before. It never really picked up after that again until we get to now we have so many millennials that are ageing into their prime home buying years and trying to transact in a market where there's not enough homes for them to buy, there was never was going to be enough supply, COVID or not, over the last year and a half, because there wasn't enough homes built to keep up with this growing population...and so we see this tight supply causing home values to increase at really rapid rates because there's so many people trying to buy and so few homes for them to buy. This is one of the reasons that this is such a different market than the financial crisis leading up to 2008.

Greg Lindsay: The decline in economic mobility is one of the many factors that shape the financial choices young adults are making today. But Holly Mazzocca, an advisor at Bartlett Wealth Management, believes today's young Americans are being driven by a more profound shift in attitudes towards work and savings.

Holly Mazzocca: When we have conversations with our younger clients, those who are in their 30s and 40s... they don't necessarily want to have one retirement date, or they say I'm going to work until age 65 and then I'm going to retire. The Stanford longevity Institute recently released a report called the new map of life. And it's a fascinating study around what life might look like in the coming generations. Five-year-olds today are expected to live until age 100. That's incredible to think about. And you may very well work for 60 years of that 100 years. But what the Stanford study pointed to is, it may not look the way it has in the past, it may incorporate a lot more flexibility. And they incorporate periods of both paid and unpaid time off, where you go in and out of the workforce. And that points to an even more dynamic financial plan, where an investor may say, you know, I really want to take some time off to be with my family. But how do I keep my skills sharp so I can re-enter the workforce later on? Or I want to take an off Route from the corporate world. And I want to try out this independent venture for a while, what is that going to do to my financial plan? How can I bake these different risks in and try to take on a new path along the way? When we look at this change, it really encourages a dialogue with an advisor from a much earlier stage in your financial life.

Greg Lindsay: In recent years, the pandemic has added to the turbulence. This has a profound effect on how individuals think about their finances, but as Vanguard's Janelle McDonald points out, it also creates difficult new choices.

Janelle McDonald: When you think about COVID, it legitimized fears we didn't even realize were there. And that fear not only threatens our lives, our freedoms and so many things that we enjoy but has also caused people to think about whether they're on strong financial footing, they've caused them to think about whether or not they're prepared to manage through a job loss, unexpected health care expenses, and things like that. There are many people that are thinking about what matters to them most in a way that is deeper and richer than they may have before. And they're reflecting on their values and how they may want to reflect those values and how they invest. And in some cases, thinking more about the legacy they might want to leave behind.

Greg Lindsay: Against that backdrop, Americans are increasingly aware that getting control of their finances can be essential to achieving their life goals, and that means more than just having a rainy-day fund. Chelsea Brennan is a former hedge fund manager who became a financial influencer, through her website Smart Money Mamas. She argues that a significant first step in the current environment is to distinguish between saving and long-term wealth building.

Chelsea Brennan: There's a crucial difference between home economics and day to day budgeting and long-term financial planning and wealth building. Things like budgeting and cutting costs and saving money. That's important to make sure that you are secure today that you make it to the next paycheck and to next month. But when we talk about really, truly building wealth, making it for a place where you can someday stop working, where if you had a disability, you could take time off, that requires thinking longer term and putting your money in a place where it is working for you. That is considering what are your goals? Where do you want to live in the future? What kind of lifestyle do you want to have in retirement and figuring out how much that's going to cost and investing for that thing? So often, we do have people who come to us and they say I've been paying off my debt. I've been thinking about my budget, I'm trying to spend better, but I'm still really worried about retirement. I still have no plan for when my kids get to college. And that's where we have to really change the conversation to not just look at the micro of today, but to look at the macro of Are you financially secure for your entire life?

Greg Lindsay: This is a paradigm shift in how we think about our finances, and it can give us a clear view of choices laid out in front of us. But it can also reveal the risks along the way. While people might feel empowered, they are also at the mercy of volatile markets, misinformation and poor choices. Economist Impact's recent survey, for instance, revealed that those without a college degree were more likely to have reduced their investments during the pandemic. That could have left them failing to benefit from the rapid rebound that followed. At the other end of the spectrum is the risk of investors chasing after every new hot stock or tip and trying to be day traders can lead them into choppy waters. Striking a balance is hard, but as Vanguard's Janelle MacDonald and Ryan Barrows point out, what is clear is that professional financial advice can help you filter the signals from the noise.

Janelle McDonald: Focus on the things you understand, focus on the things that you can control, and an advisor can really help you to look at your own personal situation, understand your goals, what do you actually want to accomplish? Right? How do you get to develop a plan and get into a broadly diversified portfolio and manage it over time...and really control costs...as cost can certainly take away from your return....and then finally, we focus on discipline. When you see volatility, when you see these things happening in the economy, how do you really make sure that you're revisiting your plan, and you're staying the course and you're being disciplined about the things that you said, and you understood as being important and making those choices again and again and again, in a way that really puts you on the right path for your long term goals?

Ryan Barrows: Americans have to navigate a huge amount of choices when it comes to saving and investing. How much are you gonna budget for spending? Are you going to save? Am I gonna invest in my retirement plan at work? And you have to think about, am I going to do it myself? Or am I going to get help? And if I'm going to get help? Who am I going to get help from if I'm going to do it for myself? Like where am I going to get guidance from and what sources am I going to trust? So I just think there's a huge amount of choice facing investors these days, which can make it difficult for folks.

So I'd say think, for the long term, decide what your investment goals are, and then stick with it in spite of whatever seems to be going on in the macro environment, that's, frankly, a place where an advisor can help. That's hard sometimes as an individual, you know, when you see it's easier now, when asset prices are at all-time highs. But in March of 2020, when the market had dropped 40%, it's harder to stay the course you know, and that's a place where I think advisors can really play a role for individuals.

Greg Lindsay: And the long run is what sound investment is all about. Americans have many choices open to them today, and that should be a good thing in democratizing wealth creation at all income levels. The broader economic headwinds of the country - from inflation and rising debt to escalating costs of education and home ownership - all mean that investment is critical to stay ahead.

In episode two, we'll talk to experts in behavioral economics, consumer finance and psychology, to understand more about how to navigate today's choice-rich investment environment and avoid the pitfalls of a volatile and complex market - and to explore how financial advice has become more important than ever.

I'd like to thank all our guests in this episode - Kara Perez, Rakesh Kocharr, Chelsea Brennan, and Nicole Bachaud, along with Vanguard experts Ryan Barrows and Janelle McDonald.

END OF PODCAST

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