Investor Profiling and Stages of Life Cycle Investing

Introduction

• The Investor Profiling process

• How the various characteristics of an individual investor at a particular point in his/her life affect his/her investment decisions.

• The stage of life cycle investing for an investor and the characteristics at each major stage
• Investor profiling is the process of identifying the characteristics and requirements that are unique to an investor.

Some of the identifiable characteristics include:

- **Age**
- **Family’s liquidity needs**
- **Investment objectives** (income, growth or balanced)
- **Risk tolerance** (conservative, moderate or aggressive)
- **Time horizon for investing** (short, medium or long term)
- **Past investment experience**
- **Level of sophistication**
- **Size of investible funds**

**Investor Profiling – Why Is It Needed?**

An investor needs to carry out a detailed profiling process to:

1. accurately reflect his/her needs in terms of objectives, liquidity, risk appetite, time horizon and personal circumstances

2. determine the suitability of the various investment products and instruments in matching his/her requirements

- Investor profiling is also part of the process known as KYC Rules (Know Your Client) which financial institutions carry out for their clients when recommending investment products

- Proper investor profiling is a requirement for all regulated financial institutions to avoid inappropriate selling of unsuitable investment products and instruments to investors
Stages of Life Cycle Investing

• Besides investor profiling, another useful tool for investors is to evaluate their distinctive phase of growth and development throughout their lifetime.

• By analysing the specific stage of his/her life cycle, an investor is able to identify and evaluate the following:

  - INVESTMENT OBJECTIVES (capital appreciation, balanced or income)
  - LIQUIDITY NEEDS for their family and themselves (amount and timing)
  - RISK TOLERANCE (conservative, moderate or aggressive)
  - Time horizon (short, medium or long term)

• As investment tools, investor profiling and the stages of the life cycle investing are analysed together in order to construct an appropriate investment portfolio

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Stages of Life Cycle Investing

The 6 different stages of life cycle investing for each investor are:

- Youth
- Young Adult with First Job
- Newly Married with Young Family
- Mid-Life with Family Needs
- Empty Nest
- Retirement Age

• The above 6 stages can be broadly grouped into 3 distinct phases of:
  1. Growth-Oriented Youth (Age : 20 – 44)
  2. Middle-Age Consolidation (Age 45 – 59)
  3. Income-Oriented Retirement (Age 60 – 80)

• At each stage of an investor’s life cycle, the objectives, liquidity or cash flow needs, risk appetite and time horizon would be very different.

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Investing Over The Life Cycle

An illustration of life cycle investing over the life span of an investor

<table>
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<tr>
<th>Stage of Life Cycle</th>
<th>Growth-Oriented Youth</th>
<th>Middle-Age Consolidation</th>
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Stages of Life Cycle Investing

• Not all investment products or instruments are suitable for an investor at all stages of his/her life cycle investing

• Different products and instruments have different market liquidity, risk levels and gestation or maturity period and thus may not be suitable for all investors due to their differences

• Typically, as investors move from one stage to the next, the whole portfolio goes through a transition to higher-quality securities

Summary

• Important tools for investors to help them in their investment decision-making process

• Identifying the important characteristics used in investor profiling and the different stages of the investor’s life cycle of investing

• With the help of these tools, investors are able to determine the suitability of the various investment products and instruments in helping them construct their investment portfolio to meet their requirements
Reference

• Gitman, Joehnk and Smart, Fundamentals of Investing
  Chapter 1 The Investment Environment

• Websites:  www.wikipedia.org
            www.investopedia.com
            www.beginnerinvest.about.com