Saving and Financial Planning:

Some Findings from a Focus Group

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January 1996

Abstract

This paper summarizes the results of a focus group on saving and financial planning. The group consisted of eight individuals with relatively high income and wealth. The savings behavior of such people is of interest partly due to their large contribution to total personal saving. The participants expressed concerns about how their circumstances will change as they age, and about uncertainties in income and health. While these concerns are consistent with theories emphasizing life-cycle and precautionary saving, the idea that saving involves self-control was also mentioned repeatedly.

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*Federal Reserve Board of Governors, Stop 180, Washington, D.C. 20551. We are grateful to Chris Carroll, Karen Dynan, Eric Engen, Myron Kwast and Dean Maki for valuable comments on this work, and to Diane Whitmore for able research assistance. This paper reflects the views of the authors, and not necessarily those of the Federal Reserve Board of Governors or its staff

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> The problem of developing an appropriate personal financial plan is extraordinarily complex. Ideally, a plan should account for earnings, earnings growth, assets, current and future rates of return, pension benefits, social security benefits, special needs (e.g. college tuition, weddings, down payments on homes), household composition, current and future tax law, mortality probabilities, disability probabilities, insurance rates, risk-return trade-offs, and a host of other factors .... Under these circumstances, is it reasonable to assume that the average individual makes well-informed financial decisions?
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> B. Douglas Bernheim (1994a, p. 55)

I. Introduction

Standard models of savings behavior assume that households plan their savings and consumption to maximize lifetime utility. Most empirical work on saving attempts to infer whether observed behavior is consistent with the concerns emphasized in theory, notably saving for retirement, incentives to save precautionarily, and the desire to bequeath wealth to heirs. To some extent, this approach is unsatisfying: even when behavior is consistent with some variant of the forward-looking, optimizing model, it remains possible that the behavior is generated by another variant, or by some other process. Understanding how saving decisions are made may be especially important for evaluating how changes in Medicare, Social Security and welfare programs may affect household saving and economic security.

In this regard, it may be valuable to investigate directly the ways in which households make saving-related decisions. To resolve intertemporal trade-offs correctly, households would seem to need to acquire and process a fair amount of information, either explicitly or implicitly. Some households undertake deliberate planning activities, such as keeping a budget, consulting a financial planner, or reading books and magazines on personal finance. While it is not known how many households take deliberate measures to plan their finances, interest in planning is sufficiently widespread to generate magazine sales exceeding $285 million and software sales of $90 million in 1994, and to keep 400,000 financial planners in business.[1] Even those who do not deliberately plan are likely to be able to provide some explanation of how they allocate income between spending and saving. If households can meaningfully articulate their approaches, self-described behavior may provide useful information on ways in which saving and consumption decisions are made.

There has been almost no academic research on financial planning by households. Some studies have investigated specific areas of personal finance, such as the accuracy of knowledge of Social Security benefits (Bernheim 1988) or the adequacy of households' life insurance coverage (Auerbach and Kotlikoff 1991). More recently, Bernheim (1994a, 1994b, 1994c) has analyzed some surveys on financial planning that were sponsored by financial institutions. The surveys suggest that people's financial planning methods are fairly rudimentary, that their financial knowledge is generally poor, and that their self-described savings plans are often inconsistent with the predictions of standard saving models.[2] It is unclear what accounts for these findings. People may lack problem-solving skills or abilities required to make sound savings decisions. Or they may not consider systematic planning to be worthwhile, especially if uncertainty in income, health, and other factors make it hard to define optimal savings and consumption plans.

Because saving and financial planning decisions are not well understood, a focus group may provide an appropriate way to explore how such decisions are made. A focus group is a form of "structured conversation," where individuals are brought together to discuss some topic of interest, with the help of a facilitator. Focus groups are widely used in marketing studies, in qualitative social

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[1]See Starr-McCluer and Whitmore (1996) and U.S. Senate (1988, p. 34).

[2]For example, while the standard savings model would predict lower savings among households expecting higher future earnings, ceteris paribus, the survey data show a positive relationship between savings effort and expected earnings growth (Bernheim 1994a, pp. 65-66).

science research, and also as an input into survey design.[3] While the focus group is by no means a representative method, it can be extremely useful for identifying ranges of behaviors or opinions, and for suggesting some of the sources of variation across individuals. Also, people can be asked to explain what goes into their thinking or behavior, providing an opportunity to pursue topics in greater depth than is possible with regular survey methods.

This paper summarizes the results of a focus group on saving and financial planning. The group consisted of eight individuals with relatively high levels of income and wealth, mostly successful business people or professionals in their fifties. While the group is clearly not representative in any general sense, the saving behavior of individuals like them is of interest for three reasons. First, relatively wealthy households are responsible for a large share of total net saving done by households.[4] Consequently, their savings decisions have a significant influence on the aggregate savings rate (see Carroll 1995; Dynan, Skinner, and Zeldes 1995). Second, relatively wealthy households hold the lion's share of stock, bonds and mutual funds owned by households (Kennickell and Woodburn 1992). Thus, their investment decisions have potentially important implications for the behavior of financial markets. Finally, one would expect high-income, wealthy people to have a fair amount of experience with saving and financial planning, so it would be particularly telling to find poorly-conceived savings decisions in a group like this. Of course, it is possible that the individuals in the current focus group differ from other wealthy households in some systematic way. Below we present some evidence suggesting that this is not the case.

The remainder of this paper is organized as follows. Section II provides background on the focus group. Section III describes the main topics of discussion, including saving motives, saving

[3]Useful references on the use of focus groups in social science research include Morgan (1993) and Krueger (1994).

[4]For example, between 1983 and 1986, 42.4 percent of net saving was done by households in the top 20 percent of the wealth distribution (Avery and Kennickell 1991).

objectives, investment strategy, perceptions of risk, and saving terminology. While people were not necessarily used to articulating their approaches to saving or investing, and sometimes interpreted standard economic terms in their own ways, much of the discussion centered around life-cycle and precautionary motives for saving, and as such provided some support for the main concerns in theoretical work on household savings. Section IV presents some concluding remarks, including some cautions about the interpretation of our results.

II. Background

The current focus group was conducted as part of the pretest of the 1995 Survey of Consumer Finances (SCF). The SCF is a triennial survey of households' assets, liabilities, incomes and demographic characteristics, sponsored by the Federal Reserve Board. The survey also asks households a number of questions about saving and financial planning, such as their reasons for saving, attitudes toward risk, and time horizons.[5] The focus group was intended to see whether people interpret these questions in the intended way, and to explore possible ways to refine them. But it also seemed like a good opportunity to investigate directly people's approaches to saving, investing, and financial planning.

The participants were recruited in Chicago by a private company. The company was asked to find eight to ten individuals having incomes exceeding $250,000, or net worth exceeding $600,000, or both, to participate in the group. The company used its contacts to identify prospective participants. Prospective participants were told the topic for discussion, and knew that the group would be composed of people like themselves. As incentive to participate, they were offered $100 and reimbursement for travel. The company ultimately put together a group of eight individuals, of whom

[5]Kennickell and Starr-McCluer (1994) and Kennickell (1995) analyze data on reasons for saving from recent SCFs.

five were men and three were women. Most were successful business people or professionals, and most were in their fifties. Brief descriptions of the participants are given in Appendix A.[6] The group met for one evening in February 1995, with dinner provided prior to the session.

Because the group is small and not randomly selected, it is possible that the focus group participants differ from other wealthy households in some systematic way. While this possibility cannot be ruled out, we have some evidence that their self-described savings behavior is similar to that of wealthy households with comparable characteristics. Before the group's discussion began, the participants answered the questions on saving and financial planning that had been asked in the 1992 SCF. Table 1 compares their answers to comparable households from the 1992 SCF. The first column contains the responses of the focus group participants. The second column shows responses for comparable SCF respondents, namely households with net worth exceeding $600,000 and a 45-60 year old head who is a professional or self-employed. For reference, the third column shows responses for all SCF respondents. Columns (2) and (3) use the sample weights intended to make the SCF data representative of the population.

Like wealthy SCF respondents, around three-quarters of the focus group partipants said their income had exceeded their spending in the previous year. 75 percent of focus group participants described themselves as regular savers who put money aside each month, compared to 53.9 percent of wealthy SCF respondents. Both groups cited retirement and emergencies as their main reasons for saving, though the shares reporting these reasons were somewhat higher among focus group respondents. Like wealthy SCF respondents, the focus group participants said their time horizon for planning their saving and spending was relatively long (5-10 years or 10 years or more). In both groups, most people described themselves as willing to take average or greater financial risks.

Thus, the focus group participants are fairly similar to other wealthy households in terms of

[6]Their names have been changed to ensure their privacy.

self-described savings behavior, although they may make more effort to save regularly, and be somewhat more concerned with retirement and emergencies than wealthy households overall. We suspect that the difference is related to the fact that participants are moderately wealthy people who have accumulated their wealth from earnings; there were no participants with very high levels of wealth, and few for whom business equity or inheritances represented a major part of their wealth.

Prior to the session, the moderator was given general guidelines for discussion, shown in Appendix B. We also spoke with her at length prior to the session, to explain our expectations concerning the topics to be covered. As is standard practice in focus groups, the moderator was free to steer the conversation as she saw fit, as long as all the subjects were covered.

III. Selected Findings

1. *Reasons for saving*. Participants were asked, "Thinking about your reasons for saving, what sorts of reasons are most important to you?" A wide range of reasons came out, including retirement, consumer durables, vacations, buying a home, children's education, starting a business, and the need to care for elderly parents. There were also several mentions of precautionary motives, including poor health, the risk of getting laid off, and the possibility of becoming frail when old. However, there was a fair amount of variation in the extent to which people had thought about reasons to save. Two people in the group volunteered most of the reasons for saving; others said they rarely think about why they save, even though they regularly put money away. One man, Phil, seemed to think about the future a great deal, expressing many ideas about things that could happen in old age--for example, that one could become increasingly frail, and not want to travel or dine out as much as before. Thus, the group's conversation provided some support for the main concerns in theoretical work on household savings--life cycle saving, and precautionary motives--though there was some variation in the extent of apparent concern with these issues.

At the same time, several participants mentioned the need to put money 'out of reach' to avoid the temptation to spend it.[7] For the most part, this need seemed to be met by transferring money out of a checking account and into a mutual fund. Perceived self-control problems have no particular interpretation in the standard savings framework, but figure prominently in behavioral theories (Laibson 1993, Shefrin and Thaler 1988). The frequent mentions are surprising, considering that these are wealthy people who have accumulated substantial amounts of savings; if they are battling against lapses in self-control, their 'forward-looking selves' would seem to almost always win. In contrast, a topic that was conspicuous in its absence was any direct mention of saving for bequests.[8]

2. *Savings objectives and financial planning*. The next area of discussion concerned how people implement their savings objectives--how they figure out how much to save, and whether they save differently for their different objectives. Some people had 'worked through' the amounts that they should be saving in order to live comfortably in retirement. At least one had used a computer program for this purpose. Another mentioned calculating the income he expected to receive from his pension and Social Security, and then figuring out what he would need to save to maintain his current lifestyle. A third noted that this sort of exercise is hard to do right; he had estimated how much they should save to pay for their daughter's college education, but it turned out to be way too low.

Most people said that they did not think of their savings in terms of specific purposes for which they put money aside ('retirement money', 'vacation money', 'college money', etc). Rather, they said they thought generally about risk and return, and the time horizon over which they would need

[7]This topic was brought up at different points by different people. The guidelines given to the facilitator did not mention this topic, so she made no effort to encourage discussion along these lines.

[8]The facilitator did not have any specific instructions to raise this subject. One woman did report, jokingly, that "When I die, my daughter's reaction is going to be, 'Mother's dead? That's too bad. WHERE'S THE JEWELRY?'"

the money. One man explained, "The older you get, the less you pigeon-hole money." Several people said they put money for the distant future into riskier assets (like stock and mutual funds), while keeping money for short-term needs in safer, liquid forms (like money market accounts). But beyond this basic distinction, people seemed to think more about how to earn good returns on their "long term money," rather than the specific needs to which it would be put, in part because "you never know what you're going to end up using it for."

Most of the participants seemed familiar with basic recommendations of financial planning. Some had hired financial planners, and most mentioned reading various personal finance columns, magazines, or books, or material provided by brokerages. However, people varied with respect to how long they had been planning, and how much effort they put into it. Some had started saving and planning early on in their adult lives.[9] Others did not start planning for retirement until later; some mentioned events that prompted them to start planning more seriously, such as seeing a parent fall into poor health, or going through a costly divorce. Only one person said she did no deliberate planning, claiming that they "make money, spend money and invest money, without much thinking about where it comes from."

3. *Investment strategy*. In terms of investment strategies, most people seemed to have strategies that follow personal finance guidelines appropriate for their circumstances. There were frequent mentions of mutual funds, and some people also have stock. One person regularly invests in residential real estate. Presumably, many people in the group also have equity interests in businesses, although no one mentioned such interests in discussing their investments.

The people who owned stock said they enjoy investing; those without stock said it takes too

[9]Two people said they began saving "as soon as we started earning more than we could spend."

much time, or that stock-picking should be left to professionals.[10] Every one seemed to read the financial press regularly, to think and talk about investments, and to monitor the returns to the assets they own. However, many said they did not spend much time overseeing their investments. One man reported, "I spend more time with my nose in the sports page than I do checking on my mutual funds."[11]

Most of the participants seemed to adjust their holdings infrequently, and were not very concrete in explaining what factors might make them sell off an asset or close a mutual fund account. A few said they do not sell stock when its price drops, because it virtually always goes back up. Only one man is an active trader, sometimes buying stock in the morning and selling in the afternoon. While he actively trades a fairly small part of his portfolio, many financial economists would consider such trading suboptimal, assuming that markets are efficient and considering that tax laws strongly favor a buy-and-hold strategy.[12] Interestingly, this is the same man, Phil, who articulated an uncannily clear vision of the future in the discussion of savings, including the likelihood that desired consumption would decline in advanced old age.[13]

4. *Willingness to take risks*. Another discussion concerned the question, "What do you think about when you think about risk?" People expressed very varied interpretations of risk, some not very close to an economist's definition. Two people thought of risk as the possibility of losing everything.

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[10]Some survey evidence suggests that individuals who trade actively do so because they enjoy it (Lease, Lewellen and Schlarbaum 1974).

[11]This is consistent with previous studies finding that most investors devote only a few hours per month to managing their money (Barlow, Brazer and Morgan 1966; Lease, Lewellen and Schlarbaum 1974)

[12]See Constantinides (1984) for discussion.

[13]When explaining why they did not trade as much as Phil, other participants said, "He knows what he's doing, I don't," or "It is fun, I just don't have enough time for it."

Another two said that risk is the possibility of loss, OR gain. Others still explained that risk is something that can be minimized by doing your homework (e.g. reading annual reports and examining price trends). There were some inconsistencies between individuals' descriptions of their willingness to take risk and the apparent riskiness of their investments. For example, the most entrepreneurial member of the group described herself as unwilling to take any financial risks. Nonetheless, the inconsistencies were more the exception than the rule.[14]

5. *Savings terminology*. Often, it was clear that people fumbled for the words to describe their views or strategies, even when they had clear ideas of what they were doing and why. For example, many people used the word 'stuff' to describe their investments. A long discussion concerned people's perceptions of whether there is a difference between 'saving' and 'investing.' To economists, 'saving' involves setting aside income to finance future spending, while 'investing' is the process of allocating savings across assets of different types. Conceivably, analysts may draw incorrect inferences from survey questions on these subjects, if people interpret the terms differently than intended.

Among the focus group participants, some people viewed saving and investing as the same, while others thought they differed in some way. Following are some ideas on this subject:

Bill: Saving is something I'm putting money into, while investments are out there, earning and growing.
Greg: Saving is anything that isn't spending.
Frank: These days you can't afford to save without investing. ... [elsewhere] ... If an investment is earning returns and you don't realize the gains, then you're saving.

In short, the participants may not have understood these terms as economists intend, although they had some appreciation of the subtleties involved. This highlights the potential for measurement problems

[14]Most people described themselves as willing to take average risks to get average returns. Indeed, from the investments that were mentioned, their financial portfolios were relatively conservative--mostly balanced mixtures of mutual funds and blue-chip stocks, with smaller amounts of higher-risk items.

in self-described savings behavior, especially considering that the current group is way above average in financial knowledge and experience.

6. *Other topics.* Several people mentioned that a divorce had had a large effect on their household finances or savings strategies. Two men said that a divorce settlement had unexpectedly depleted their financial assets. Some one else explained that a harsh divorce had taught her to keep a "pile of cash that's just there." At one point, the facilitator asked the group what they might do differently in terms of saving or investing, if they could do it all again. One man replied, "I would have started saving earlier. I would have invested regularly over the years. And I would have figured out a way to keep my ex-wife from getting all of the above."

There was also an active discussion of childhood experiences with saving. Several people had begun saving regularly very early in their lives, for example, out of their incomes from paper routes. Others did not begin saving until they were adults. Some people described how they had encouraged their own children to save, doing such things as setting up savings accounts or giving them Walt Disney stock. One woman pointed out that not all children follow what their parents try to teach them: she had encouraged her kids to save, but one grew up to be frugal and the other is a spendthrift. Another man, who had set up savings accounts for his children, later described how he had to bail a daughter out of burdensome credit card debt.[15]

The last question of the session was, "What single piece of information would you want your kids to know about saving and investing?" Among the pearls of wisdom that people volunteered were "Buy low, sell high," and "Microsoft."

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[15]Lawrance (1991) summarizes some research in this area. Bernheim (1994c) presents some evidence that individuals who were exposed to financial decisions while young typically save more as adults.

IV. Concluding Remarks

To summarize, when asked to explain their reasons for saving, people expressed concerns about how their circumstances will change as they grow older, and about uncertainty related to health and income. The emphasis on topics related to life-cycle and precautionary saving provides some support for the main concerns in theoretical work on household savings. At the same time, some points that came up repeatedly do not have a clear place in the standard view, such as the the idea that saving involves self-control. Other ideas that came up have not received much attention in research on savings behavior, including the role of divorce.[16]

A note of caution is important in interpreting our results. Because of the group's unusual composition, it is perhaps not surprising to find saving behavior consistent with standard savings models, and investment decisions that seem reasonably well-informed. We have no way to know whether these results would apply for less wealthy people, nor can we be sure that the focus group participants are typical of wealthy people overall. It would be interesting to investigate how the self-described savings decisions of other types of people differ from those with high income and wealth. Nonetheless, the current study suggests the need for care in research along these lines, since informative descriptions of savings behavior may be difficult to elicit.

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[16]For an empirical study along these lines, see Sullivan (1995).

Table 1. Representativeness of Focus Group Participants

	Focus Group Participants	1992 Survey of Consumer Finance (weighted): HHs with Net Worth > $600,000, Head aged 45 to 60 and professional or self-employed	1992 Survey of Consumer Finance (weighted): Memo item: All households
Description of saving last year			
Spending was less than income	75.0	79.7	57.3
Spending equalled income	25.0	12.3	28.0
Spending exceeded income	0.0	7.9	14.7
Usual savings behavior			
Save regularly, put money aside each month	75.0	53.9	36.6
Spend regular income, save other income	12.5	11.7	4.4
Spend income of one family member, save the other	0.0	2.8	1.7
No regular plan	0.0	24.6	32.3
Don't save	12.5	7.1	25.9
Stated Reasons for Saving*			
Retirement	62.5	55.5	26.6
Emergencies	50.0	38.5	42.0
Major Purchase	25.0	6.9	10.2
Family	12.5	1.8	4.4
Buy a home	12.5	1.4	5.6
Investments	12.5	12.8	10.0
Education	0.0	23.0	14.3
Time horizon for saving & spending			
Next year	25.5	14.9	36.6
New few years	12.5	19.9	26.2
Next 5-10 years	37.5	43.3	22.2
Longer than 10 years	25.0	21.8	15.0
Willingness to take risk in savings and investments:			
Substantial or above-average	25.0	29.9	14.4
Average	62.5	54.7	37.2
No financial risks	12.5	15.4	48.4

*May sum to more than 100%.

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APPENDIX A. Description of Focus Group Participants

Greg (35)
Attorney

Richard (54)
Self-employed professional

Bill (41-50)
President, small company

Ellen (51-60)
CEO, small firm

Susan (51-60)
Academic

Margo (50)
President, service company

Phil (50)
CEO, medium-sized company

Frank (60)
Partner, service firm

Mary
Moderator

APPENDIX B. Basic Script for the Focus Group Discussion

1. Introduction

While you were completing the Section J questionnaire, what sorts of things did you have to consider to answer the questions?

2. Saving/Investing

In your view, is there a difference between saving and investing?

Probe: Do they differ in terms of objectives, goals, or purpose?
Is one long-term and the other short term?
Is one more goal-specific than the other? If so, which?

3. Investment/Savings Objectives

Thinking about your reasons for saving, what sorts of reasons are most important to you?

[LIST ALL POSSIBLE REASONS ON THE BOARD]

What are some of the things you have saved for in the past?

[ADD TO LIST]

If not mentioned by respondents, the following will be suggested by the moderator: retirement/old age
education for children
caring for aging parents
saving for a rainy day/emergencies
part of the way I was raised
buy a home

Do you tend to put aside money differently and separately for each of your savings goals?
- If so, what are some of the differences in the ways in which you save or invest for specific goals?

4. Financial Planning

We've talked about why you put money aside, now I'd like you to think about what type of financial planning you do to meet your objectives. I'd like us to talk about the process involved, rather than the specific investments you chose.

Would you say that you deliberately plan your savings and investments, or do you make decisions as specific needs or opportunities arise?
- What determines how deliberately you plan?

When planning your savings and investments, what type of time horizon do you have? A few months ahead, a few years ahead, or what?
- What aspects of your circumstances, experience or personality influence your time horizon?

Again, when planning your savings and investments, how does risk affect your decisions?
- What types of risk are you concerned about?
- How does your concern for risk affect your choices?
- What do you think is an appropriate level of risk for some one like you?

How has your approach to planning changed over time?
- What do you do differently? What are you doing the same?
- What events or experiences have made you alter your approach?

5. Portfolio Decisions

Would you call yourself an active investor, or a passive investor?

How frequently do you check the performance of your investments?

What types of things would make you think about making a change in your portfolio?
Would it be an event (birth of a child, illness, death of some one your age, etc)?
Or would it be information (tip from an associate, news about financial markets, etc)?

When you make decisions about your investments, what sources of information do you consult?
* media (local newspapers, magazines, radio, TV, newletters)
* financial professionals (stock broker, accountant, banker, etc)
* friends, coworkers, parents, other acquaintances
* other

6. Wrap-Up Questions

If you knew when you were younger what you know now, what would you change?

What single piece of information would you want your children to know?