Wealth, Happiness, and the Hedonic Treadmill: Ramifications of the Puzzle for Wealth Managers

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Distinguishing Features of Wealth Management

The term "wealth management" has received considerable attention recently in the trade press, but there is no consensus about what it really means from a practical standpoint. Writing in *Registered Rep* magazine, John Churchill notes that wealth management is a phrase often used with "reckless abandon."[1] To the skeptics, it is just another new marketing "buzzword" that offers nothing more than traditional comprehensive financial planning under a new rubric ("old wine in new bottles"). Others, however, view wealth management as a distinct orientation in the provision of financial services to "super wealthy" clients ($1 million plus in investments)[2] and perhaps even to the "mass affluent" (i.e., persons with $100,000 to $1 million to invest)[3].

An article in *Portfolio Organizer* (October, 2005) by T. S. Rama Krishna reported that the "new kid on the block," wealth management, is meant to help clients "get a complete perspective of their wealth."[4] A similar view was presented in an industry report from Schwab Institutional, titled *"Strategies for Building a Successful Wealth Management Firm,"*[5] which claims that "wealth management is a holistic approach that seeks to coordinate high-net-worth investors' needs over their lifetimes with the needs of their families" (p.5). Based on these definitions, though, it is quite reasonable to wonder just how wealth management differs from comprehensive financial planning, which some would define with very similar terms. What is it exactly that *distinguishes* wealth management from other financial services?

According to the results of a Fidelity Investment-sponsored study conducted in 2004, the primary feature of wealth management differentiating it from other financial advisory services is that the client–advisor relationship is "broader and deeper." The report based on this study – "*Independent Thinking on: The Wealth Management Imperative*"[6] – states that "When asked to describe what distinguishes their services from other types of financial advisors, wealth managers emphasize the uniqueness of their client relationship—relationships that are **broad** in terms of encompassing all areas of a client's financial life and **deep** with respect to the advisor's intimate knowledge of a client's values and priorities'' (p.4).

Writing in the March, 2006 issue of *On Wall Street* magazine, George H. Walper Jr. and Catherine S. McBreen discuss the results of a U.S. survey of households with $500,000 or more in assets to invest. According to the study, there is a trend among investors (58% of the men and 66% of the women) to view the advisor as a "counselor." The article concludes: "To retain and attract new clients, advisers should position themselves as providing holistic advice--not just investment information. In the past, most advisers have concerned themselves only with their clients' investable assets. Affluent individuals, however, are increasingly becoming interested in

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[1] Churchill, J. (2005, June 1). In praise of pruning. *Registered Rep.* Available at http://registeredrep.com/mag/finance_praise_pruning/
[2] Silver, L. (2006, March). In praise of small clients. *On Wall Street Magazine.* Available at http://www.onwallstreet.com/article.cfm?articleid=3258
[3] Schmerken, I. (2002, January 7) Wealth management: The race to serve the mass affluent. *Wall Street & Technology.* Available at http://www.wallstreetandtech.com/story/mag/WST20020107S0001
[4] Rama Krishna ,T.S. (2005, October) Wealth management: The new kid on the block . *Wealth Optimizer*.
[5] Schwab Institutional (2001). *Strategies for building a successful wealth management firm.* San Francisco, CA: Charles Schwab & Co., Inc.
[6] Fidelity Registered Investment Advisor Group (2004). *Independent thinking on: The wealth management imperative*. Boston, MA: Fidelity Investments.

all aspects of their financial lives and have begun gravitating to professionals who offer holistic advice."[7]

The Need to Understand Client Psychology

The Schwab International report also notes that wealth managers may become involved in aspects of the clients' lives that other financial advisors might not consider appropriate, acting as a type of concierges. Obviously, knowledge besides finance and investing is essential if one is to function effectively as a wealth manager. In recent years, financial advisors of all types have come to recognize the role of psychology in the provision of financial services to clients. An article in the *Journal of Portfolio Management* coauthored by Mark Riepe – a VP at Charles Schwab & Co. – and psychologist Daniel Kahneman – the 2002 winner of the Nobel prize in Economics – alerted practitioners to some of the main mental biases that financial advisors need to recognize in their clients, noting: "Financial advising is a prescriptive activity whose main objective should be to guide investors to make decisions that best serve their interests. To advise effectively, advisors must be guided by an accurate picture of the cognitive and emotional weaknesses of investors that relate to making investment decisions: their occasionally faulty assessment of their own interests and true wishes, the relevant facts that they tend to ignore, and the limits of their ability to accept advice and to live with the decisions they make." [8](p. 52).

If the prominent feature of wealth management (i.e., deep knowledge of client goals and values) is more than mere hype, then the wealth manager needs to appreciate the psychological state of the client more than any other financial services professional. Indeed, a core area in the certificate in Wealth Management program offered by New York University[9] is the psychology of wealth management[10] because psychological skills are considered necessary for candid discussions of money-related topics. In our opinion, of particular importance is the need for the wealth manager to understand the role that wealth plays in determining happiness, a topic that is often neglected in even the psychologically-oriented discussions of wealth management.

Happiness as a Goal for the Client.

The motive to strive for happiness is a universal, biologically-based drive in humans. In fact, the United State's Declaration of Independence (from Great Britain) contains the following passage, generally attributed to Thomas Jefferson: "We hold these truths to be self evident: that all men are created equal; that they are endowed by their Creator with certain unalienable rights; that among these are life, liberty, and the pursuit of happiness." If one has a right to happiness, happiness ought to be a goal to be achieved. But how exactly does an individual go about becoming happy? Most people, implicitly or explicitly, believe that more money and the additional purchasing power it brings will permit one to better pursue happiness.

Understandably then, many wealth managers may view the ultimate aim of their profession to be the creation of greater wealth for their clients. The untested assumption is that more money will increase the client's satisfaction with life in general (not to mention that it will

[7] Walper . G.H. & Mc Breen, C.S. (2006, March). The shape of things to come. *On Wall Street Magazine*. Available at http://www.onwallstreet.com/
[8] Kahneman,, D. &. Riepe, M.W. (1998). Aspects of investor psychology. *Journal of Portfolio Management, 24*, 52-65.
[9] http://www.scps.nyu.edu/departments/ certificate.jsp ?certId=851
[10] http://www.scps.nyu.edu/ departments/course.jsp?courseId=62360

also make them more pleased with the services of the wealth manager!). So it must have come as quite a shock to many wealth managers when a couple of years ago there appeared a provocative editorial in the magazine *Wealth Management* (1st Quarter, 2004, p. 31) titled "Wealth and Happiness: Striking a Balance."[11] It was written by Professor Richard Layard, the Director of the Well Being Programme in the Centre for Economic Performance at the London School of Economics, who argued that the pursuit of wealth without regard to other meaningful aspects of life is bound to be a self-defeating strategy. In his one-page editorial, Professor Layard succinctly referred to some of the surprising findings from the scientific literature on the nature of happiness, especially on the lack of a strong relationship between wealth and happiness, but he could hardly do justice to the complexity of the issues in the limited amount of space allotted to his editorial. Given that this topic should be required knowledge for wealth managers, our article will attempt to present a more extensive and objective coverage of this matter. The aim is to acquaint readers with the essential points of this literature, although we too will have to gloss over much detail.

Defining and Measuring Happiness

For centuries, philosophers in both the West and the East have speculated about the nature of happiness.[12] Traditionally, the scientific study of happiness has been the purview of primarily psychologists and sociologists but more recently economists and biologists have become involved in research on this topic as well. Based on these investigations, we now have access to a body of scientific information about happiness. Happiness is generally defined as "the subjective enjoyment of life." In many studies, the terms "subjective well being" or "life satisfaction" are used instead of the word "happiness," but the concepts definitely overlap (although some researchers do not consider them to be identical).[13]

The results of surveys that have been administered over a number of years (60 for some) are available, and they can be used to compare "happiness" not only between different individuals, but across different countries as well. Moreover, such surveys can be the basis for analyzing how happy people were years ago compared to today. These surveys ask questions like: "*Taken all together, how would you say things are these days – would you say you are very happy, pretty happy or not too happy*? [14] or "*All things considered how satisfied are you with your life as a whole these days?*" [15] A popular measure of happiness, called the "Satisfaction with Life Scale" consists of five questions where responses are given on a scale from one to seven.[16]

A study of this type collected self-ratings of life satisfaction from more than six thousand college students from 43 nations.[17] The average life satisfaction ratings, on a seven-point scale, ranged from a low of 3.3 in China to a high of 5.4 in the Netherlands. The U.S. scored an average rating of 4.7. India was 4.4, and the averages from some other Asian countries were as follows: Korea, 3.8; Hong Kong, 3.9; Taiwan, 4.0; Japan, 4.0; Indonesia, 4.4; and Pakistan, 4.5.

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[11] Layard, R. (2004, 1st Quarter). Wealth and happiness: Striking a balance. *Wealth Management*, .31.
[12] Haidt , J. (2005). *The happiness hypothesis.* NY: Basic Books
[13] Veenhoven, R. (20000. The four qualities of life. *Journal of Happiness Studies*, *1*, 1-39.
[14] Davis, J.A., Smith, T.W. & Marsden, P.V. (2001). *General social surveys, 1972-2000: Cumulative codebook*. Chicago, Ill.: National Opinion Research Center.
[15] Inglehart, R &.Klingman, H.D. (2000) *World value surveys and European values surveys 1981-84,1990-93,1995-97 ICPSR version*, Ann Arbor. MI: Institute for Social Research and Inter-university Consortium for Political and Social Research.
[16] Pavot, W. &. Diener, E. (1993).The affective and cognitive context of self-reported measures of subjective well-being. *Social Indicators Research, 28,* 1-20.
[17] Suh, E., Diener, E., Oishi, S., & Triandis, H. C. (1998). The shifting basis of life satisfaction judgments across cultures: Emotions versus norms. *Journal of Personality and Social Psychology, 74,* 482-493.

Can Money Buy Happiness?

A fundamental notion in economics is that having money makes people happy. To answer the question of whether "money can buy happiness," one needs to address the relationship between money and happiness from several perspectives: (a) how happy are the rich and the poor within a given country at any given point in time? (b) are there differences in the happiness of different nations as a function of their wealth?, and (c) does happiness change with increases in income or wealth?

Rich and Poor in any Country. First, let us consider the data on the happiness of the poor and the rich within any given society. As William Bernstein points out in his book, *The Birth of Plenty*[18], in every society, the rich(er) are happier than the poor(er). Surveys show that on a 7 point scale where 1 equals "not at all satisfied with my life" and 7 equals "completely satisfied," people living in the slums of Calcutta score 4.6 on average while the homeless in that city average 2.9, a difference that would not be surprising to most people.[19] To some extent then, money does buy happiness (or more accurately, is correlated with it). However, the relationship is not as strong as one might assume. On this same survey, the average score of respondents from *Forbes*'s annual list of the 400 richest Americans was only 5.8, not appreciably higher than that of the dwellers of Calcutta who must sleep on the sidewalks. Likewise, some 20 years ago, researchers surveyed 49 of the 100 wealthiest Americans and found that while these people were slightly happier than average, the difference was not very dramatic.[20] Lottery winners offer another example: generally, they are not much happier than most people. While they do experience a joy shortly after winning, within a year, they usually revert to their former happiness level, and some are actually less happy than before. [21] Newspapers are full of stories with headlines such as the following from the *Boston Globe* (December 14, 2004): *"For lottery winner, $113m hasn't bought happiness.* The correlation coefficient between wealth and happiness is meager, on the order of only 0.20.[22] Generally, the poorer the nation, the higher the correlations is between the two.

Furthermore, the relationship is not linear. At some point, as the law of diminishing returns dictates, additional wealth produces less and less additional happiness. Dr. William Bernstein observed that in order to match the happiness that results from increasing one's income from $10,000 to $100,000 per year would require a jump to $1,000,000 per year.[23] Some years ago, it was reported that at a per capita income of $15,000 - $20,000 is where the point of diminishing returns begins to operate. In other words, after one is able to meet the necessities for maintaining a middle class lifestyle, additional wealth adds only a bit of happiness.

Gross Domestic Product (GDP) and Happiness. Next, it is necessary to examine differences in aggregate happiness between countries and see if there is a link to their average level of prosperity. There are numerous studies that have correlated the Gross Domestic Product or average per capita incomes of various countries and the average level of happiness within the

[18]Bernstein, W.J. (2004). *The birth of plenty: How the prosperity of the modern world was created.* NY: McGraw Hill-.
[19] Diener, E. & Seligman, M.E.P. (2004). *Beyond money toward an economy of well-being. Psychological Science in the Public Interest, 5,* 1-30.
[20] Diener, E., Horowitz, J., & Emmons, R.A. (1985). Happiness of the very wealthy. *Social Indicators Research,16,* 263-274.
[21] Brickman P, Coates D, & Janoff-Bulman, R (1978). Lottery winners and accident victims: is happiness relative? *Journal of Personality & Social Psychology,36,* 917-27.
[22] Easterlin, R.A.. (2001) Income and happiness: Toward a unified theory. *Economic Journal 111(473),* 465-484.
[23] Berstein, W.J. (2003, Spring).The retirement calculator from hell, Part V: The unhappy implications of the Easterlin hypothesis. *Efficient Frontier: An Online Journal of Practical Asset Allocation*. Available at http://www.efficientfrontier.com/

country. Here too there is a positive relationship. Generally, the more affluent is the country, the happier are its citizens.

However, while there is some truth to the statement that the citizens of more prosperous countries have greater happiness than the citizens of the less prosperous countries, one can find exceptions to the generalization. For example, Diener and Suh[24] report that life satisfaction in India (5.15) is higher than in Asian countries with higher per capita incomes, such as Korea (4.98), Hong Kong (5.07), and even Japan (5.14). Obviously, other factors than money must be involved in determining the populace's satisfaction with life. According to Dutch psychologist Ruut Veenhoven[25] of Erasmus University, the correlation may be illusionary because authoritarian states generally have both a low GDP and low happiness. Conversely, wealthier countries are also characterized by democratic and efficient governments that provide security, equality and allow their citizens freedom, and this may be the reason why the residents of the wealthier countries are happier, not the wealth per se.

Impact of Economic Progress on Happiness. The issue becomes even more complicated when happiness over time is studied. The industrialized world's per capita gross domestic product has been growing by about 2% a year over the last 50 years. In year 2000, according to Bernstein, the real per capita gross domestic product of Mexico was larger than that of Great Britain in 1900, when the latter was one of the world's leading economies. Surely, if wealth and happiness go together, then the degree of happiness in the world today is much higher than it was in earlier times. Unfortunately, that is not the case. In the industrialized nations, happiness has not increased with economic gains. For example, between 1958 and 1987, Japan's per capita GDP increased fivefold, yet happiness remained relatively flat. Richard Easterlin, the researcher who first observed this counter-intuitive finding in the early 1970s, finds it to still be true: "I had found no significant relationship between happiness and time over a period in which GDP per capita grew by one-third, from 1972 to 1991." [26](Easterlin 1995, pp. 37-38). Simply put, various studies show that there exists a modest correlation between income and happiness within a given country and a more sizeable one between the wealth of nations and the happiness of their inhabitants, but there is no effect of income increases on subjective well-being on either individuals or nations. These are very puzzling findings.

Reasons for the Easterlin Paradox

The "Easterlin Paradox." is the name given to the puzzle that (1) richer nations and households are happier than the poorer nations and households, but (2) that increases over time in per capita income in the industrialized nations has not resulted in greater happiness. Three interconnected explanations have been offered to for the paradox: genes, habituation, and standards people use to judge how well-off they are.

Genes. Research shows that an individual's genetic makeup has considerable bearing on how happy the person will be during his or her lifetime. One theory is that we are born with a certain "set point" for happiness around which our happiness will fluctuate up and down based on life events. The set point for most people is somewhat above neutral, given that most people are on the happy-end rather than on the sad-end of the sad-to-happy continuum when multipoint

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[24] Diener, E. & Suh, E. (1999). National differences in subjective well-being. In D. Kahneman,, E. Diener, &. N. Schwarz (eds.) *Well-being: The foundations of hedonic psychology*. New York: Russell Sage Foundation.

[25] Veenhoven , R. (2000). Freedom and happiness: A comparative study in forty-four nations in the early 1990s. Cambridge, MA: MIT Press.

[26] Easterlin, R.E.(1995). Will raising the income of all increase the happiness of all?. *Journal of Economic Behaviour and Organization*, *27*, 35-47.

scales are used to assess happiness.[27 28] What happens to us during our lives will raise or lower our happiness for a time, but eventually it will return to this genetically preset level.[29]

People fail to realize that temporary intense feelings of happiness or sadness tend to dissipate quickly, and often they make rash decisions that cannot be reversed (such as committing suicide). Time does heal most wounds. According to Professor Ed Diener of the University of Illinois, people usually adjust to life's ordinary pleasant or unpleasant events within 3 to 6 months.[30] As hard as it is to believe, even after a spinal cord injury, most individuals report feeling happy most of the time as early as three weeks later.[31] In a recent *Time* magazine interview, Dr. Daniel Kahneman explained why: "Everyone is surprised by how happy paraplegics can be…the reason is that they are not paraplegic full time. They do other things. They enjoy their meals, their friends. They read the news. It has to do with the allocation of attention." [32] However, events such as the loss of a spouse, loosing one's job, and the birth of a handicapped child seem to lower happiness for fairly long periods for most people.

Convincing evidence for genetic influences on happiness comes from comparisons of identical and fraternal twins. Identical twins have all their genes in common, whereas fraternal twins only share about 50% of their genes, just like ordinary siblings. To determine how much of a role heredity versus environment plays in a psychological trait, scientists compare the extent of the correlation of the trait in identical and fraternal twins. The larger the difference between identical and fraternal twins, the greater is the role of genes and the smaller the role of the environment. A second way to study the "heritability" of a trait is to compare the frequency of a trait among identical twins raised apart since infancy. Because the genes are the same, any observed differences must be due to the environment in which they were raised.

Both lines of evidence point to the strong influence of heredity. Identical twins are equally happy about 44 % of the time, whereas fraternal twins experience the same level of happiness approximately 8 % of the time.[33] It has been estimated that somewhere between 40% to 50% of our happiness *at any moment* is inherited [34] Thus, how one feels currently is determined equally by life's circumstances and one's genes. However, studies examining the component of happiness that is stable over a lifetime find that it is about 80% genetic. In other words, how you feel right now could be due as much to the environment as to your genetic makeup, but how you will feel *on average* over the rest of your life is largely genetic. Some research has identified the biochemical channels that genes employ to create feelings of pleasure and displeasure, such as levels of the neurotransmitters dopamine and serotonin.[35] Studies of the neural systems involved in sensations of happiness point to the left prefrontal cortex as the locus for this emotion.[36 37]

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[27] Diener, E. & Diener, C. (1996). Most people are happy. *Psychological Science 7*, 181-185.
[28] Myers, D. G. & Diener, E. (1995, May). The pursuit of happiness. *Scientific American, 274* (5), 54-56.
[29] Lykken, D. T. & Tellegen, A. (1996). Happiness is a stochastic phenomenon. *Psychological Science,* 7 (3), 186-189.
[30] Goleman, D. (1996, July 16). Forget money: Nothing can buy happiness, some researchers say. *New York Times*. B5, B9.
[31] Myers, D. G. (1992). *The pursuit of happiness*. New York: William Morrow.
[32] Wallis, C. (2005, January 17). The new science of happiness. Time. Available at //time-proxy.yaga.com/time/archive/preview/0,10987,1015902,00.html
[33] Lykken, D. T. & Tellegen, A. (1996). Happiness is a stochastic phenomenon. *Psychological Science,7* (3), 186-189.
[34] Hamer, D. H. (1996). The heritability of happiness. *Nature Genetics 14* (6), 125-126.
[35] Hamer, D. H. (1996). The heritability of happiness. *Nature Genetics, 14* (6), 125-126.
[36] Lemonic, M.D. (2005, January 17). The biology of joy. *Time*. Available at http://time-proxy.yaga.com/time/archive/preview/0,10987,1015863,00.html
[37] Lane, R. D., Reiman, E. M., Ahern, G. L., Schwartz, G. E., & Davidson, R. J. (1997). Neuroanatomical correlates of happiness, sadness, and disgust. *American Journal of Psychiatry, 154*, 926-933.

However, these results on the biological substrates of happiness should not be taken to mean that our genes predestine us. A study published in 2000 by researchers from the Netherlands notes that the correlation in happiness from year-to-year over 11 years ranges from about .45 to .54, and that the correlation between the first and the 11th year is only .29, although one needs to recognize that measurement error (such as haphazard responding) tends to lower the true value of the relationships. Nonetheless, the article suggests that if we rank-order people by their degree of happiness currently and at the end of their lifetime, only 30% of that rank order would remain the same.[38] Indeed, one of the pioneers in the genetics of happiness, Professor David Lykken, who first proposed the set-point theory has changed his mind somewhat. According to a recent Time magazine article (January 17, 2005), he has come to regret his original conclusion about the futility of becoming happier ("It may be that trying to be happier is as futile as trying to be taller.") In the interview he indicated: "I made a dumb statement in the original article…It's clear that we can change our happiness levels widely--up or down."[39] (In case his original proposal is true and some of us are destined to be unhappy, most of us would probably prefer to be rich and unhappy than poor and unhappy; at least we could afford therapy that way.)

Habituation. Generally, the pleasure we derive from life events is due to the increase in stimulation that the event produces. Over time, however, people become accustomed or “habituated” to most things and therefore we no longer find them as pleasurable as when we did at first. Moreover, people tend to overestimate both the intensity and the amount of long-term pleasure they'll obtain from owning a material good. Researchers call this the “impact bias” [40] [41]The level of pleasure we get from possessions becomes lower with continued consumption because we get acclimated to them and start taking them for granted.[42] (Recall the adage about the two happiest days in a boat owner’s life—the day he bought the boat and the day he sold it.) After a while, even the benefits of additional income disappear, as shown in an analysis by Frey and Stutzer (2000) who found that habituation can nullify nearly 70% of the pleasure resulting from an increase in income.[43]

Social Comparisons. The psychological value of something is not based on its absolute value, but how it deviates from some reference point. Our happiness depends a great deal on how we construct our reference point(s). People are competitive by nature, and therefore most people evaluate how well they are doing by comparing themselves to some reference group. If we are doing better than our reference group we are happy, and unhappy if we are faring worse than this reference group. We tend to benchmark our status by our relative position in a group. There is ample truth to the definition of happiness found in the 1911 edition of the *Devil’s Dictionary*, written by American humorist Ambrose Bierce, who defined happiness as: “An agreeable sensation arising from contemplating the misery of another.”[44]

People who are objectively better off may see themselves as worse off because of their benchmark.A study of the emotional reactions of silver and bronze medalists at the 1992

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[38] Ehrhardt, J.J., Saris, W.E., & Veenhoven, R. (2000). Stability of life-satisfaction over time. *Journal of Happiness Studies, 1*, 177-205.

[39] Wallis, C. (2005, January 17). The new science of happiness. *Time*. Available at //time-proxy.yaga.com/time/archive/preview/0,10987,1015902,00.html

[40] Gertner, J. (2003, September 7). The futile pursuit of happiness. *The New York Time*. Available at http://www.wu-wien.ac.at/usr/h99c/h9951826/nytimes_happiness.PDF

[41] Loewenstein, G. & Schkade, D.(1999). Wouldn’t it be nice? Predicting future feelings. In D. Kahneman, E. Diener, & N. Schwarz (Eds.), *Well-Being: The Foundations of hedonic psychology*. New York: Russell Sage, pp. 85-108.

[42] Di Tella, R., MacCullock , R. & Oswald, A.J. (2003). The macroeconomics of happiness. *Review of Economics and Statistics, 85*, 809-827.

[43] Frey, B.S. & Stutzer, A. (2002). *Happiness and economics: How the economy and Institutions affect well-being*. Princeton, NJ: Princeton University Press.

[44] http://www.alcyone.com/max/lit/devils/h.html

Summer Olympics showed that even though the silver medalist did better than the bronze medalists, the bronze medalists were happier. The reason was the reference point. The bronze medalists were happy that they at least earned a medal, whereas the silver medalists focused on the fact that they were only a fraction of a second in many cases from getting the gold.[45]

If one's income goes up, and so does everyone else's, so that his or her relative position in the distribution remains the same, satisfaction will probably not increase substantially from the raise. Relative income matters more than absolute income in determining happiness. That is, people evaluate their income or wealth in relation to what is the typical income in a given society.[46] Surprisingly, comparisons to other countries are rare, [47] perhaps because most people are unaware of the state of affairs in other nations.

Research shows that if a neighbor's income is higher than one's own, it has a detrimental effect on one's happiness, even if one's own income went up. In one such study, it was found that the so called 'neighbor effect" was more influential on the people who socialized within the neighborhood compared with people who socialized outside the neighborhood.[48] Likewise, in the United Kingdom, workers who used a high-income group as their reference point were less satisfied with their own jobs.[49]

So even though all of us can afford more goods today than people could a hundred years ago, the degree of pleasure is no greater because <u>everyone</u> today can afford them. Certain "status" or "luxury" goods are prized not because they are inherently more durable or function better, but because they remain unaffordable to many.[50] [51] For example, many of the high priced watches are no more accurate than the mass-produced quartz watches, despite the tremendous difference in price.

The Hedonic Treadmill

Because the more we have as a society or as individuals, the more we aspire to have, our desires remain unsatiated. We remain stuck on what has been described as living on a "hedonic treadmill." [52]An easy to suggest solution is that we ratchet down our expectations. Unfortunately, this recommendation ignores the fact that loses loom larger than gains, so that a drop in income or wealth is likely to hurt 2 to 4 times more than an equivalent increase would bring pleasure. Few people would be capable of living at a lower standard of living than their current friends and neighbors. In his editorial, Professor Layard advocated imposing a tax on people who refuse to get off the hedonic treadmill "because huge sacrifices of private life are made in pursuit of higher income. If much of this sacrifice is self-defeating, we should discourage it in the standard way that we discourage other forms of pollution and addiction-by taxing it." (p.31). His proposal, however, goes against the principles of a free economy and would probably stifle human progress. Other more reasonable solutions must be sought to help a person achieve a balance. Perhaps the answer is to make people realize that the pursuit of

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[45] Medvec, V. H., Madey, S., & Gilovich, T. (1995). When less is more: Counterfactual thinking and satisfaction among Olympic medal winners. *Journal of Personality and Social Psychology, 69,* 603-610.

[46] Stutzer, A. (2003). The role of income aspirations in individual happiness. *Journal of Economic Behavior and Organization, 54,* 89-109.

[47] Hagerty, M.R. & Veenhoven, R. (2003). Wealth and happiness revisited: Growing national income does go with greater happiness. *Social Indicators Research, 64,* 1-27.

[48] Luttmer, E. (2004). Neighbors as negatives; relative earnings and well-being. *NBER Working Paper 10667.*

[49] Clark, A. E., & Oswald, A.J.(1996). Satisfaction and comparison income. *Journal of Public Economics, 61*, 359-381.

[50] Frank, R.H. (1985). Choosing the right pond: Human behaviour and the quest for status. London: Oxford University Press.

[51] Frank, R.H. (1989). Frames of reference and the quality of life. *American Economic Review, 79* (2), 80-85.

[52] Brickman, P. & Campbell, D. T (1971). Hedonic relativism and planning the good society. In M. H. Appley, (ed.)., *Adaptation level theory* .New York: Academic Press, pp. 287-302.

wealth needs to be moderated by other goals, creating a realistic reference group, and not having open-ended goals for wealth.

What Does Make One Happy?

Hopefully, the reader now realizes that while a certain minimum income or wealth is necessary to be happy, anything above and beyond that has a dubious impact on happiness. Wealth is not the most important factor in happiness. So what does matter in making one happy? In 1967, a researcher named Wilson[53] conducted a review of the then available studies and concluded that to be happy one should be a "young, healthy, well-educated, well-paid, extroverted, optimistic, worry-free, religious, married person with high self-esteem, job morale, modest aspirations, of either sex and of a wide range of intelligence" (p. 204). A more recent analysis, conducted Diener, Suh, Lucas & Smith[54] reaffirmed some of these earlier conclusions, but questioned others. Today, well-being is thought to be associated with extraversion, optimism, high self-esteem, a sense of personal control, religion, and being worry free. However, some cross-cultural studies suggest that self-esteem is more critical to the happiness in Western countries.[55] Some studies on the relationship of happiness to age suggest a non-linear relationship---young people and old people are more satisfied with their lives than people in middle age--- but others fail to find any relationship. Married people are indeed happier, but that may be the reason why they are married. A higher level of education is not necessarily needed for happiness. A number of studies point to the importance of having a network of friends and strong ties to family. In his book, *Flow: The Psychology of Optimal Experience*, psychologist Mihaly Csikszentmihalyi contends that to be happy, we need to absorb ourselves in activities that require our talents but do not either under-challenge us (which leads to boredom) or over-challenge us (which results in stress).[56]

Implications for Wealth Managers

Proponents of wealth management stress that successful practitioners must know their clients' values, lifestyle, ambitions, and priorities. Wealth managers, like other financial services practitioners, tend to equate client happiness with the accumulation, management, and growth of financial wealth. Very little attention is devoted to determining how wealth impacts a client's overall level of happiness. In other words, it is often assumed that generating higher rates of return and increasing portfolio values will inherently lead to increased happiness on the part of clients. As this paper suggests, this core assumption, held by nearly all financial services practitioners, is problematic at best and potentially dangerous at worse.

Financial services practitioners, especially those that call themselves wealth managers, ought to seriously consider the ramifications of the research reported in this paper. There is little evidence to suggest that wealth and income and happiness are linearly related. Indeed, in almost every study that has looked at the relationship between wealth and happiness the relationship shows signs of diminishing returns. The super wealthy are not significantly more happy than the modestly wealthy. The modestly wealthy, in turn, exhibit roughly the same level of happiness as those who have accumulated minimum levels of wealth. Financial services professionals can best serve the interests of clients by helping clients achieve a balance between

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53 Wilson, W. (1967). Correlates of avowed happiness. *Psychological Bulletin, 67,* 294-306.
54 Diener, E., Suh, E. N., Lucas, R. E., & Smith, H. L. (1999). Subjective well-being: Three decades of progress. *Psychological Bulletin, 125,* 276-302.
55 Diener, E., & Diener, M. (1995). Cross-cultural correlates of life satisfaction and self-esteem. *Journal of Personality and Social Psychology, 68,* 653-663.
56 Csikszentmihalyi, M. (1990). *Flow: The psychology of optimal experience.* New York: Harper & Row.

the pursuit of wealth and the use of wealth in ways that maximizes happiness. Few financial planners have the academic training to acts as psychologists for their clients, but they should be conversant enough with this topic to able to be spot potential problems.

Wealth managers would be well served to meet both the financial and emotional satisfaction needs of their clients. Successfully implementing a financial plan depends on how well a wealth management practitioner knows his or her client, and how strong the planner-client relationship is at the time a recommendation is made. Understanding the relationship between wealth and happiness is another tool that wealth managers can use to strengthen their bonds with clients. Those advisors that attempt to bridge the gap between wealth satisfaction and psychological wellness will, in almost all cases, create a deeper and longer lasting advisor-client relationship.