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The Basics of a Financial Plan

Personal financial planning concentrates on the three main financial stages of life.

Understanding the issues and the steps necessary to navigate through these stages is not necessarily difficult; but sometimes, life can be!

Real life issues crop up; jobs change, marriages dissolve, illnesses strike, goals and priorities change, and so on. An effective financial plan is therefore made of a basic structure of prudent financial thinking and strategy, sprinkled liberally with flexibility and portability. What I offer below is the foundation for good strategy along with a list of the important issues that should remain at the forefront of your thinking about money. When properly framed, the financial questions that life creates are often easily answered through continuous reference to a good financial plan.

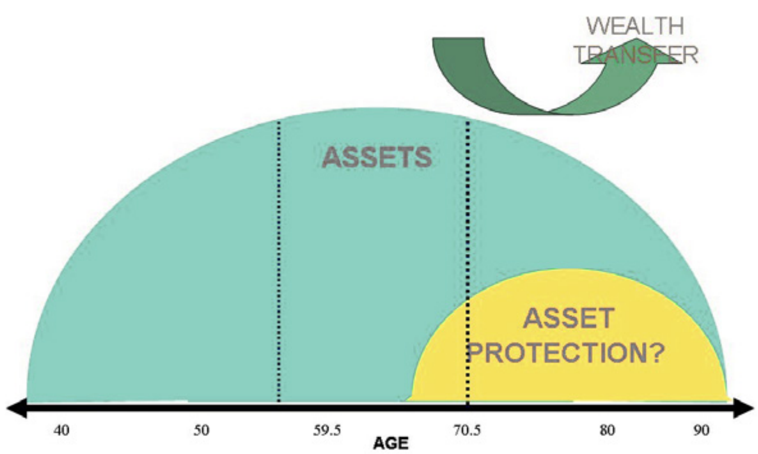
To begin, one should understand that there are three basic phases of financial life.

You will find that each phase has a set of unique concepts and strategies that typically center on the normal financial instruments and concepts with which you are familiar: investments, insurance, income taxation, etc.

The Accumulation Phase has to do with answering the question: Do I have enough? Or better said, how do I get enough?

The Distribution Phase is typically the "retirement years." The principal issue is: Will my money last as long as I do?

The Transfer Phase centers on the question: How much wealth will I pass on to my heirs or to charities?



Accumulation Distribution

Lifecycle of Wealth

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The 3 Main Financial Stages of Life

The Accumulation Phase

The Accumulation Phase has to do with answering the question: Do I have enough? Or better said, how do I get enough? How should I save, invest, and protect my money so that I can do the things I want to do in the future like buy a house, buy a car, educate my kids, retire, and so on?

When we first meet clients, this is often the phase in which they are operating. They are attempting to amass the critical amount of capital to accomplish their goals. They are also buying or maintaining insurance to fulfill the goal if they happen to die prematurely or become disabled.

The vast majority of your financial life is spent in the Accumulation Phase, the period of time over which you are working, saving, investing, trying to avoid taxation, and building your future.

It makes sense that most financial publications are centered on this topic in one way or another, yet I believe most of these well-intended outlets for advice tend to be less than helpful.

The Distribution Phase

The Distribution Phase is typically the "retirement years." The principal issue is: Will my money last as long as I do? Because we really do not know how long you will be retired, this phase tends to be unpredictable in length and in magnitude. We do know that on average, this phase is lengthening and that most people should plan for a 30-year retirement.

Over such time, the most crucial risk folks face is the specter of a tripling of prices. Investments that maintain purchasing power and insurance that provides lifetime income are central to planning in this phase.

The Transfer Phase

The Transfer Phase centers on the question: How much wealth will I pass on to my heirs or to charities? Because the timing of your death is unpredictable, we have to plan ahead for this phase. Proper legal documents like a will or a Trust are essential, as well as a thorough discussion about your plans with close friends or family members.

Due to the confiscatory nature of the federal estate tax and the state-imposed inheritance tax, good tax planning and prudent use of life insurance can also be integral parts of the Transfer Phase plan.

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The Most Effective Approach

The problem is that so much advice is centered on specific items and decisions.

What's the best mutual fund? Should you participate in your employer's stock plan in your 401K? These are certainly reasonable topics of discussion, but the problem is that it is impossible for a disinterested third party to properly frame the questions on these topics within the context of your personal situation. No one can do this unless and until they actually know who you are and what you are trying to accomplish. Thus, only by your own diligent effort with the assistance of a dedicated financial planner can you adequately confront these issues.

The most effective approach is to begin with a financial plan that presents the big-picture view of what you want to accomplish and when you want to accomplish it. The correct answers to the generic questions "Which mutual fund is best?" or "What life insurance should I buy?" can only be answered when we know what results you want. Put another way, how exactly does Money magazine know that the ABC mutual fund is the right fund for you when they have no idea what you are investing for? Is it the right investment for your kid's college fund? Your retirement fund? Your daughter's wedding fund? If your son starts college in three years, your daughter is getting married in eight years (how would you know that?), and you plan to retire in 17 years, no investment could possibly be right for all those purposes.

What makes a "good" mutual fund or "good" life insurance?

Well, there certainly are particular attributes that we look for with all investments and insurances. In any financial instrument, there are some basic requirements that must be satisfied before we can call it "good" or even "best." However, the proper question is not whether the instrument is good; we all have a pretty good idea of what is "good," or at least, we know what we should avoid at all costs. The proper question is whether it is appropriate.

Assuming that journalists and commentators are smart enough to be able to distinguish between what is a bad financial instrument, a good one, and even a great one, this still does not offer the right perspective. We need to be able to say which of the good or great instruments is appropriate for the situation. Let's face it: a $150,000 30-year mortgage at 3.5% from a sound mortgage lender is an excellent choice for a 25-year-old couple trying to buy their first house. But the same instrument is meaningless to an 87-year old widow who needs an income supplement to stay in her home while she receives home health care. It is likewise meaningless for a property developer who needs ten times that amount to finance a building project.

The power of a financial plan

The only way we can properly evaluate the effectiveness of any financial product or service is within the context of one's own financial needs. Specifically, within a financial plan that delineates your goals, needs, and actual financial position, what financial products are available in the marketplace that would be appropriate to use?

We throw away the options that are not suitable or effective, analyze the remaining options that could do the job, and choose the one or two that give you the highest probability of success. That's the power of a financial plan; it provides the framework by which these decisions can be made.