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Thoughts on financial plans



Financial Thoughts

by John Schooler

Financial plans used to be forbidding, book-length tomes that, not surprisingly, no one read. These days a plan tends to be more of an outline.

A good financial plan spells out goals and the means to work toward those goals. But whatever a plan looks like, its purpose is the same: to coordinate short-term needs with long-term goals.

To visualize a financial plan, just look at your hand. The five fingers represent retirement, tax planning, estate planning, investment management, and insurance. The space between your fingers represents the plan itself. Each part of your financial plan can help you get where you want to go, and each can operate separately, but real strength comes when all five fingers act in unison.

You could create a college savings account, for instance, without worrying about how it would affect your retirement plan. You could use a simple rule of thumb to decide how much life insurance to buy rather than considering what would be needed to replace your income, pay for your children's education, and help your spouse retire comfortably.

But it makes sense to use the whole hand, because all of these things are interrelated. Suppose, for example, that you struck it rich during the 1990s bull market. Maybe you used some of the gains to pay off your mortgage, freeing up more of your earnings to put into your retirement plan. However, income taxes went up because you lost your mortgage interest deduction. And oh, your expanded net worth meant that estate taxes would also become a problem. To create a financial plan, an adviser first must probe the details of your financial situation:

- What are your objectives?
- How do you feel about risk?

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- How old are your children, and where do they want to go to college?
- What kind of pension or 401(k) plan do you have at work?
- Are you hoping to leave an inheritance for your children, or are you willing to exhaust your savings in retirement?

Once your needs are understood, a plan is put together to connect the dots. Your investment plan takes into account your risk tolerance and is designed to fund your current and long-range goals.

Those objectives, in turn, are based on what college will cost, the income you'll need in retirement, the amount you want to leave to your children etc. The plan also stipulates how much insurance will be required to protect your family if you die prematurely, and whether insurance should be part of your estate plan.

Before having a financial plan prepared, there are some important considerations:

- Who will prepare the plan? The person who prepares the plan should present it. He or she will know how the numbers were derived and will be able to present alternatives.

- How many plans has the individual prepared? There is no substitute for experience. Ask to see a sample plan.

- How much will the plan cost? The amount will vary depending on the plan's complexity. Fees range from several hundred to thousands of dollars. If you are buying a fancy financial plan for a nominal amount, be aware that a sales pitch might follow.

Importantly, no financial plan is a once-and-done document. It's part of an ongoing process of checking progress, making adjustments and getting back on track when life derails your best-laid plans. If you have another child, receive an inheritance, lose your job or get divorced, a good financial plan, like a helping hand, should be able to pull things back together again.

For questions, call or e-mail John Schooler, CFP®, ChFC, CFS at 858-677-0477 or john@wfpsecurities.com. John Schooler is the President of Western Financial Advisors and WFP Securities. WFP Securities Member NASD, MSRB and SIPC.