



Personal finance



# Financial planning - the big questions

by Jason Holmes, Lumen Financial Planning,

In dealing with local business owners and successful professionals, there are two questions that are regularly asked. Individuals are usually enjoying a good level of success in business, they are making growing profits / earnings and are starting to think about their future and the lifestyle they want to live at 'retirement'. And 'retirement' will mean different things for different people.

Inevitably they begin to ask me

- How much money do I need in my 'retirement' pot (their number) to provide the future lifestyle I want? and;
- What can I do to ensure it does not run out?

These are vital questions to ask and to receive clear answers on as they will provide a strong foundation for future asset accumulation.

So how can these questions be answered with a degree of accuracy and in a common sense, logical and systematic manner so that individuals can set in place a plan to accumulate the required assets to provide them with their future desired lifestyle.

The answer to that is by using lifetime cashflow modelling. This is a cashflow plan for the rest of your life. It will provide you with a picture of your financial future and show you what you need to do now to make up any shortfall you may have to provide the future lifestyle you want. It puts your financial planning into context with your life goals and gives you an opportunity to do something about the things you do

not like the look of.

It is an invaluable tool in planning. It is not based on a shot in the dark or guesses about the future; it is based on your personal circumstances and what you and your professional adviser believe are reasonable assumptions about the future.

In fact the assumptions that you use are key to the cashflow providing projections that are as accurate as possible. The assumptions need to be reasonable and reasoned and you should ensure that your adviser is competent in deciding what assumptions to use.

In being reasonable and reasoned they need to be based on accurate data. For example, for inflation what has been the historical rates but also what are the long term targets for the Bank of England.

For investments, if you invest in the stock market you would expect to receive a 'risk premium' over 'risk free' investments such as short dated gilts, as you are taking more risk with your money. What risk premium does your adviser use and why do they use that percentage in calculating the return rate in your cashflow?

Every effort must be made to make the assumptions as accurate as possible. However, they will always be wrong. We may use a reasoned expected level of inflation of 2.5 per cent per annum. However, it may be three per cent per annum over the long term. This 0.5 per cent per annum over the long term can affect the eventual outcome so it is essential that the cashflow is rerun every year with current values and projections. Think of it as a roadmap leading you to a particular destination.

You need to keep checking to ensure you are on the right track.

## So how does it work in practice?

A recent client, Mr Jones, wanted to retire in five years at age 60. His wife, who is 13 years younger, wanted to work on but wanted to stop at age 55, 10 years before her final salary pension would be payable.

The cashflow model (figure one) showed that the capital they had accumulated would run out at his age 73 as it was being used to supplement their drop in income from his age 68 to 78 (her age 55 to 65).

There was a gap between income and the cost of their lifestyle between his age 68 and 78. Their current capital saved would only cover a part of this shortfall and calculations showed that they needed to save £500 per month to his age 68 to have sufficient capital to supplement their income shortfall.

Their mortgage was being paid off within the next six months and so it was affordable to save this amount each month. It was also agreed that from his age 80 the income requirement would be less as they would be spending less on their lifestyle, so a slightly lower figure was used. The result is the cashflow model in figure two. This shows that their capital will not run out based on the assumptions that were used.

This cashflow is reviewed each year and adjusted as circumstances and investment growth changes.

Lifetime cashflow modelling should be an essential part of your planning for your financial future. However, it is only as useful as the data entered and therefore it is vital that you use a professional adviser who knows what they are doing.

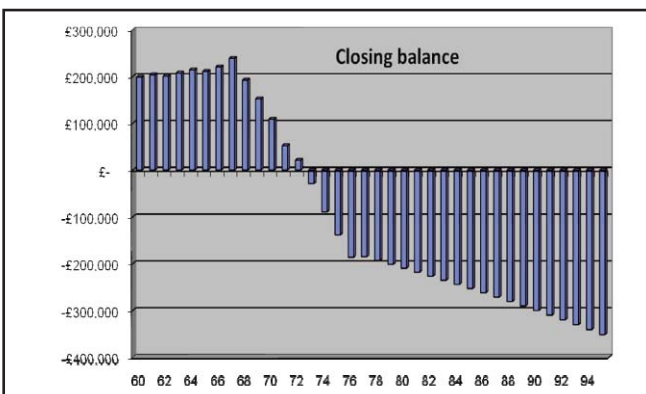


Figure One

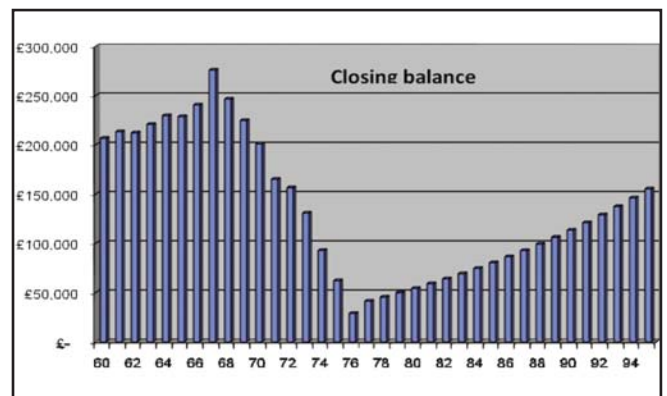


Figure Two

Jason Holmes is a Certified Financial Planner and owns Lumen Financial Planning Limited. He can be contacted on 3831 2995 or Jason@lumenfinancialplanning.com