GRAYISSUE

Make financial planning a priority in 2013

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Research from the US* shows that financial planning is a critical factor separating those who are on track to meet their financial goals and those who are falling behind. With the beginning of a new year traditionally a time of resolutions, why not make financial planning your priority in 2013?

Source: www.behaviorgap.com**

Having a plan and a process in place to achieve your goals is key

But where to begin? People often make the mistake of asking which product they need without realising this is the wrong place to start. The critical starting point is your long-term plan. A plan is like your destination; it gives you an idea of where you want to land up. It forms the foundation of all your decisions. Once your plan is in place you can establish a process to follow that plan. The process deals with how you will reach your destination and achieve your goals. The final step is choosing your product. Inverting the triangle in the illustration makes no sense as you cannot choose an appropriate product until you know what you want to achieve.

Answering some key questions is an excellent starting point and will give your plan some structure:

How long do I want to invest for?

Being clear on your timeframes is important as some investment products have restriction periods – and you don't want to get into a situation where you cannot access your money. Additionally, different asset classes (i.e. shares, bonds, property, cash) are suitable for different timeframes. Your investment horizon is determined by your goal, e.g. the length of time until your children start university or the number of years until you would like to retire, versus if you need to start an emergency fund, or have lifestyle goals, such as buying a new car or taking a trip. Generally, the longer you have to invest the more flexibility you have in terms of how much risk you can afford to take.

What's my attitude to risk and potential returns?

You need to decide how much risk you are prepared to take on to achieve your desired returns. Think about how comfortable you are with losing money (on paper) over the short term in order to achieve returns in the long term. Put differently, how much short-term stability are you prepared to sacrifice to increase your chances of achieving better long-term returns. Understanding your risk appetite will help you when you have to make asset allocation decisions.

Asset classes with the potential for greater returns come at the expense of increased risk of capital loss as well as increased short-term volatility. Therefore, if you want to enjoy the benefit of a greater lifetime income, you must be prepared to tolerate both these risks.

Do I want capital growth or income, or both?

Your choice of investments depends on whether you want your savings to increase (i.e. give you capital growth), or give you regular payments (income). This is something else to factor into your asset allocation decisions. Getting the asset allocation balance right is difficult. Before you begin, you should consider how much growth you need to sustain your investment and how much risk you can afford to take. Based on this, you should look for assets that offer long-term growth potential, and allocate capital to these assets based on your risk appetite and ability to handle decreases in income.

Only once you have answered these questions can you begin to look at products that may meet your needs. Starting with your plan means achieving clarity about personal financial goals.

An independent financial adviser can help you formalise your plan and choose products and funds that are well suited to your circumstances. Remember though, you need to regularly revisit your plan to make sure you are on track to meet your goals, and to make sure your goals still work for your reality.

* The CFP Board/Consumer Federation of America Household Financial Planning survey

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