The Levers to Financial Freedom

By Russ Thornton
September 1, 2009

Advisor Perspectives welcomes guest contributions. The views presented here do not necessarily represent those of Advisor Perspectives.

"Give me a lever long enough and a fulcrum on which to place it, and I shall move the world." -Archimedes

Virtually the entire financial services industry is built upon spending vast amounts of time, money and other resources on things over which we have absolutely no control – like attempting to manage investment returns.

By focusing on those things you can control, however, you as a financial planner can build better, more resilient plans for your clients. Pushing or pulling on the key levers in those plans lets you adapt to changes in the market or in your clients' circumstances – keeping you in control and ready to adapt to unforeseeable events.

I recommend a passive investment strategy using low-cost, highly diversified funds and ETFs. But, regardless of how you invest, no one knows how the market will perform tomorrow or next year, much less five years from now, or even twenty-five. Even if we disagree about the best way to invest, we stand on common ground with regard to the simple fact that the future, for everyone, is unknowable. Managing investment returns is something we can't control.

So if investing represents something we can't control, what are some of the things that we can?

In most financial matters, we exert some degree of control over three primary areas:

- Time
- Cash Flow
- Risk

Endless articles and opinions detail the minutiae of financial planning and investing, but everything rolls up into one of those three categories, which constitute the levers you control in the financial planning process.

© Copyright 2009, Advisor Perspectives, Inc. All rights reserved.

Time

Many decisions in the financial planning process hinge on time frames which are inherently flexible. How long until your clients plan to retire, buy a home, or send their kids to college? Will there be a time when they anticipate the need to care for their parents?

Time also captures the duration of a financial event. Most people plan for their kids to attend college for four years (although the five-year plan seems pretty popular these days). But what is their life expectancy? Or, if they lose their job, how long will they be unemployed and without income?

The lever of time covers a lot of scenarios – some more certain than others. Even still, a basic truth always holds: the sooner you start to plan for something, the better prepared you'll be to deal with the inevitable surprises and detours you'll encounter during your journey.

Cashflow

Cashflow is the amount of money coming into or going out of a financial "household." If you spend more than you earn, then you're running a deficit – as does our esteemed government. Your clients' credit cards will be stacked against them as they plan their financial future.

On the other hand, if you're spending less than you earn, you have the ability to save and invest. The more your clients save, the less dependent they are on the performance of their investments to secure their financial independence.

Risk

You can take risk without realizing a return, but you can't have return without taking some risk, despite what some infomercials would have you believe. While you might want to rely on projected investment returns to help secure your client's financial future, you have to first make sure you're taking the right risks that can produce those expected returns.

I don't mean to imply that the more risk you take, the more return you will get or that this risk/return relationship has no upper limit. Risk and return are highly dependent on taking the right types of risks, the kinds that have the highest probability of being rewarded.

I encourage my clients to only take on as much risk as will let them confidently plan to reach their most important goals and objectives. Taking unnecessary risk is the

© Copyright 2009, Advisor Perspectives, Inc. All rights reserved.

equivalent of gambling, and there's no reason for your clients to do this to themselves or their families.

There are other risks – market timing, investment picking, interest rates, purchasing power and more. Identifying those risks and whether or not they have a reasonable potential for reward is essential for sound financial planning.

Using Levers in the Planning Process

Let's move forward with what we know: We can't control returns, but we have varying degrees of control over time, cashflow and risk. We can push and pull these three financial "levers" to accommodate our clients' financial situation.

How should you incorporate these levers into your financial planning process?

To plan properly, one must apply to the concept of financial advice an entirely new paradigm, by looking at your goals in different and unique ways.

In the most widely used financial planning models, clients provide their "planner" with a set of data, much of which isn't even that important. For example, how relevant to your clients' financial future is the amount they paid their phone company last month? Yet many planners insist on gathering this detailed level of data for their clients, even though doing so is time-consuming and potentially uncomfortable for the client.

Clients are typically asked to complete a multiple-choice "risk tolerance questionnaire" designed to do two things: reduce an advisor's liability in case of a future disagreement about their investments and allow clients to take on the maximum amount of investment risk that they can stomach, regardless of whether or not they actually need to.

Clients are asked to provide many other pieces of data to create their financial plan, and one of the most important is their planned retirement age. Unfortunately, rather than discussing this in a manner that makes it something clients can look forward to, the way many planners frame this discussion serves to encourage clients to work as long as they are physically able.

The Ideal Financial Planning System

It's hard to know where to start correcting this illogical system, so let's reframe the problem and ask ourselves: What would the ideal financial planning system offer?

Planners should focus only on data that's directly relevant to their clients' financial plans. They must promote a healthy and sometimes emotional discussion about "acceptable" goals but also accommodate the inclusion of "ideal" goals – hopes and

© Copyright 2009, Advisor Perspectives, Inc. All rights reserved.

aspirations. Planning should be a client-focused process designed to make the most of the one life clients have.

Perhaps most importantly, proper planning involves an ongoing review of the three levers that are under our control.

Let's say we determine that a client is willing to work until age 62. I want to also know when they would ideally like to retire. Would they retire at 60 or 58 or 55 if they could be confident that they could afford to do so?

How about retirement expenses? What if a client is willing to live on $80,000 per year in retirement, but would love to consider living on $110,000 per year. Or, what if they're currently saving $27,500 per year, but would like to explore whether they can save less now in order to enjoy more of their financial resources today?

Remember, this is about making the most of the one life your clients have.

What if a client is deathly afraid of the stock market? Proper financial advice should not "sell" anyone on the benefits of stocks or push a client out of their comfort zone. My goal is to take as little risk as possible while still maintaining comfort and confidence that my clients can achieve everything that's important to them. To instill comfort and confidence in financial plans, clients can consider taking on more investment risk, but this must be a choice and not a requirement.

These are but a few examples of the different levers you can push and pull to impact your clients' financial situation.

Prioritizing Your Financial Levers

For some clients, it's more important to enjoy the fruits of their labor today. By working an extra year or two longer, a client can defer their retirement in exchange for the opportunity to save less money each year leading up to retirement. I'm sure they can think of some great family vacations or other treats they could enjoy each year by reducing their annual savings. How many financial planners ever discuss the possibility of saving less?

Others might be burned out at work or eager to pursue a second career – they can't retire soon enough. Those individuals would be willing to save more today, temper their retirement lifestyle and increase their investment risk, all in an effort to retire as soon as possible.

The best solutions for these clients are found in the interplay of the different levers that can be pushed and pulled to accommodate your clients' financial situations.

© Copyright 2009, Advisor Perspectives, Inc. All rights reserved.

Let's say that it's December 2008, and we've just come through one of the worst years in the history of the investment markets. What should your clients do?

Well, first of all, advisors should have been meeting and discussing plans with their clients on a quarterly basis throughout 2008. The right financial planning system cannot be a product that you use once and only update or revisit every few years. Proper planning is an ongoing, proactive advisory relationship. Your clients shouldn't have been caught off guard at the end of 2008; you should have been involved in regular conversations and updates with your clients throughout the year. A "set it and forget it" approach to financial advice doesn't work.

But let's say your investments are down 25% and you're worried that your clients will have to work indefinitely and fight to stay above the poverty line.

What about your levers – focusing on things you can control like time, cashflow and risk? Clients might have to consider working an additional year or two, but a good financial planner will have already discussed that possibility early in the relationship.

Consider the concept of "ideal versus acceptable" goals I discussed above. That wasn't just a "feel-good" exercise. The economy and your clients' finances don't exist in separate vacuums, which means your clients will inevitably need to change their plans. By having the conversation upfront about both what they'd love to do and what they're willing to do, you've already established a range of possible alternatives that they can revisit. Maybe they originally said they were willing to work until 62 but would love to retire as early as 55. Let's say we planned for them to retire at 58, and because of the drop in the market they have to consider working two more years to age 60. Or maybe they'll have to save a little more than they prefer or take more investment risks. Only by proactively focusing on the things they can control and regularly reviewing and updating their outlook can you truly have an impact on your clients' financial plans.

While this fact is probably a fading memory, remember the market can go up too. What happens if the market has a nice run over the next several months? Proper planning should accommodate the opportunity to retire earlier, spend more in retirement, save less each year, reduce investment risk, or some combination.

A Real Life Example

I met with two of my clients in June 2009, after the market hit recent lows in March and had started to go up. The market was still well below its peak in 2007.

These clients are hard-working, middle-class Americans in their late 50's. The husband is a former policeman now working in the private sector and his wife is an executive assistant. They earn a nice income, but, more importantly, they save a lot and live

© Copyright 2009, Advisor Perspectives, Inc. All rights reserved.

within their means. They've reared two children and now have three grandchildren. They're great people.

We began the planning process about a year ago and established their ideal and acceptable goals. I delivered advice that reflected their priorities and things that are important to them. We struck a nice balance between their ideal and acceptable goals, and they were happy with the advice going forward. We have regular updates and conversations, but our latest review was that June meeting

In updating their information in preparation for the meeting, I discovered something that surprised me. Through disciplined savings and the recent market performance, they were now able to achieve *all* of their ideal goals. I confirmed that I'd updated everything properly and together we reached the same conclusion. These clients were on track to achieve each and every one of their ideal goals.

I had never encountered this and did not know what to do. My financial planning vendor offered some advice I will never forget: In the rare instances when this happens, a good planner should help his clients formulate a new set of ideal goals.

I'll pause and let that sink in for a moment…

These clients had achieved everything they ever dreamed of, and I was in the fortunate position to go back to them and deliver the good news. Better still, I had one of the most rewarding client appointments I've ever experienced in my 16 years of delivering financial advice. We met for about an hour and brainstormed about things they never even considered.

Some amazing things happened. We talked about how they would love to be in a position to share some of their wealth with their family while they're still living. We created an annual travel budget to allow them to plan a family vacation every year and cover for their children and grandchildren as well as for themselves.

These clients are hard-working, and I told them they could retire at their ideal retirement age. But upon further discussion, the wife confided to me that she'd love to retire one or even two years earlier so she could spend more time with her mother while they were both still in good health.

She got misty eyed as we discussed this possibility.

And the icing on the cake was to consider moving their investments to my most conservative asset allocation. In their ideal goal set, they couldn't consider my least risky investment allocation; however, in their new ideal goal set, it was under consideration.

© Copyright 2009, Advisor Perspectives, Inc. All rights reserved.

If you think this story doesn't get better, I'm happy to report that it does.

After reviewing their new ideal goal set relative to their financial resources, we couldn't achieve everything, but we were able to plan for the wife to retire a couple of years earlier than previously planned, something they identified as their highest-priority goal. We were also able to lower their investment risk and partially fund their annual family vacation goal. This is advice done right.

How would these clients be affected if the market goes down 30% or more from its current levels?

I would go back to them and have a new discussion to generate new advice. The new advice may be to go back to their prior ideal goal set, or it may require even more significant changes. Fortunately, these clients know that things will change and they now have the benefit of experience, having seen how pulling and pushing the levers they control keeps them in the driver's seat.

After all, it's all about the clients, isn't it?

Russ Thornton is the founder and President of Thornton Wealth Management, a fee-only advisory firm based in Atlanta, GA. The concepts of identifying ideal and acceptable goals in dollar values and timing of goals, of investment risk, and the relative and/or proportionate priority amongst these goals as a constantly evolving advice process are the intellectual property of Wealthcare Capital Management and its patent pending Wealthcare advice process. Thornton uses Wealthcare in lieu of traditional financial planning.

www.advisorperspectives.com

For a free subscription to the Advisor Perspectives newsletter, visit:
http://www.advisorperspectives.com/subscribers/subscribe.php

© Copyright 2009, Advisor Perspectives, Inc. All rights reserved.