

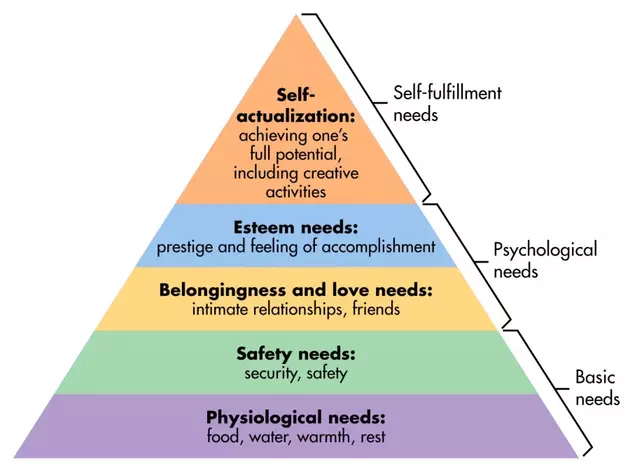
Post COVID-19 Playbook for Personal Financial Planning

Matthew Carbray, CFP®, ChFC®, CLU®

Let me start by saying that I hope that you and your family are safe and healthy. For those who are on the front lines of this global health pandemic, I can’t thank you enough for the sacrifices you are making to cared for our loved ones. As the days pass and more lives are unfortunately lost, this will certainly hit home for a lot of you, and for that I am truly sorry. I can say with the highest level of conviction that I could not think of a better country to call home, and while we may have our differences as a society, hopefully this crisis can bring us closer to together. This has become more of a race between the global medical and biotechnology community and the virus transmission than anything else. But we need to start preparing for the new normal, and that is what I intend to focus on as it relates to the typical individual. Hopefully this playbook can serve as your guide in the days to come.

PLAYBOOK ACTION STEP #1 (Emergency Reserves)

If I go back to my days as a college student, I am reminded of Maslow’s Hierarchy of Needs. Abraham Maslow in his 1943 paper “A Theory of Human Motivation”, provided a five-tier model of human needs in which he suggested that individuals needed to satisfy needs on the bottom of the hierarchy before they could move upward to satisfy other needs.



Source: <https://www.simplypsychology.org/maslow.html>

As you see from the pyramid, our basic needs are imperative to survival and without solidifying those societal necessities, our survival is at risk. Let’s transition this discussion to the parallels between Maslow’s motivational theory relative to personal financial planning.

One of the foundations of financial planning is the importance to prepare for an emergency. We could look to Maslow and put that in the category of a Physiological need. But let’s expand on that. As an eternal optimist, (those that know me will affirm that fact), it can be hard to think of a time like this when some of us may be unemployed, underemployed, and unable to carry on in our lives with the liberties afforded to us. We are living in a new normal for sure, but if we don’t learn from our experiences we are likely to repeat them. From a 2018 USA Today story, Maurie Backman of The Motley Fool went on to say, “Experts agree that for true protection from financial emergencies, it's best to sock away up to six months' worth of living expenses in the bank. For the typical household in a major metro area, that's about $23,000. But the average American has less than $4,000 in savings, while 57% of U.S. adults have less than $1,000 to their names.”

No one household is identical to another. Debt and income levels, the consistency and predictability of one’s income, the amount and ages of dependents, and other non-financial distinctions such as age, health, and family status all need to be evaluated in the calculation of determining an appropriate level or emergency reserves. In our post COVID-19 playbook, priority #1 should be to build your emergency reserves because the next emergency is out there, we just don’t know when. Now the level of emergency reserves will and should vary by situation. Let’s look at the following examples:

Jim and Susan Smith are both employed. Jim works in the health care field at one of the prominent hospitals as a general physician. Susan works for the town in the payroll department as a unionized employee. Their monthly expenses are about $10,000, including their mortgage which is 3 years from being paid off. Their adult children are off the family payroll and their college expenses have been paid in full. Their combined income is $300,000 per year and they save aggressively for retirement to the tune of $40,000 per year. They seem to be on track to meet their long-term goals.

Steve and Sara Walker are enjoying the American dream of first-time home ownership. They have just started a young family and Sara is staying at home caring for their new daughter Michaela. Sara may or may not return to work as a dental hygienist. Steve has done very well historically as a realtor in their local market, although he has been through the cycles of real estate and has seen his income fluctuate $50,000 in either direction on a year over year basis. He expects in a normal year to make $125,000 after real estate expenses to run his practice before taxes. They expect to have expenses to run the household of $7,500 per month although the house is old and problems could arise.

In the case of Jim and Susan, they have the benefits of stable employment and consistent earnings. They also may be approaching retirement when their retirement assets may be available for withdrawal without penalty (age 59 ½). I would argue they could be comfortable with a much lower level of emergency reserves. In their case, $30,000 would be a reasonable amount as that equates to 3 months of spending. If Jim and Susan had taken additional action to establish an individual life and disability insurance plan, I would say their plan is solid and secure.

Now let’s transition to Steve and Sara. Due to the cyclicality of their household income coupled with the addition of a new child and a new home, there is a lot of stress on their situation. With a single source of income, that only compounds the risks of an emergency. I would advocate in their case that they really need to have accessible 6, and preferably 9 months of expenses or $67,500. That is undeniably a significant sum and it is unlikely that can be accomplished with any velocity, but it is imperative in my eyes. That should be their focus over the next few years. If Sara returns to work, that would only shorten how long it may take to build the level of savings. This to me is Priority #1.

PLAYBOOK ACTION STEP #2 (Risk Management and Insurance)

Before we move upwards on Maslow’s pyramid, there is one area of planning that needs to be solidified before we proceed. In the case of Jim and Susan from above, they not only had positioned themselves to cover their emergency needs, but they had a solid foundation due to the personal insurance planning they had in place. Jim and Susan were covered by a group and individual disability plan (in Jim’s case it protected 80% of his income in total) and they both had ample life insurance that was a blend of term and permanent insurance. Risk management and insurance is one of the foundational aspects of any financial plan and the effective implementation further eliminates the biggest threat, the loss of one’s income. Saving for future goals can now be prioritized as a result.

Let’s get back to our friends Steve and Sara. They are at a different point in their lives and their exposure to an emergency event in terms of probability and impact is much more pronounced. What if Steve were to pass away at a young age with a non-working spouse? Could she return to work with a young child? What about the mortgage payments and household expenses? The focus of their planning needs to be on protection as much as building an emergency reserves bucket. Perhaps a large term life insurance policy for an extended term like 30 years would be a smart decision for the two of them. Steve should be prioritizing on setting aside as much as possible in an emergency reserves account before he focuses on saving for retirement and future educational expenses.

PLAYBOOK ACTION STEP #3 (Budgeting)

What I think will emerge out of this unprecedented period in our country’s history is an appreciation for what we have. I have long said that, “What good is one’s wealth if you don’t have your health.” That statement rings true more today than ever before. I hope that you are getting some down time to focus on what is important. I also am of the opinion that consumers will start to become more aware of their spending. Do I really need a new car, is that bigger house necessary, and could I cut out the membership for (insert here) that I don’t use are all questions we will be asking ourselves. The ripples to be felt in the economy will extend beyond the period when we are back to some semblance of normalcy as consumers change their spending habits. Why jump on a plane when we can take a car ride to a vacation spot 3 hours away? Why attend a sporting event with 40,000 people when I can watch it at home on high definition TV? I have become the next Emeril and really like eating at home with family, do I really want to go to a restaurant surrounded by people to pay for an overpriced meal? Unfortunately, much as we experienced in 2009 through the Great Recession, there will be businesses that won’t make it throughout this crisis. Jobs will be lost, some industries will be a shell of their former selves, and personal consumption will be much lower.

A lot of these thoughts are likely going through your mind. What I would recommend is for you to look at your household expenses in a post COVID-19 world. Yes, the amount of toilet paper and macaroni and cheese costs should go down. Here is what I suggest…create a list of needs, wants, and wishes. The likelihood is the needs will make up at least 60% of the list. Those include, food, paying the mortgage and applicable taxes, and utilities and health care costs at a minimum. The wants could be categorized or described as…I want to take a family vacation, I want to paint the house because it is peeling, and I want to maintain a gym or golf membership. You may find some of these wants are absolutely necessary for your own sanity or because the result of not following through could create a bigger problem. But there may also be an opportunity to eliminate a few needless expenses. Are we really going to watch streaming subscription TV 4 hours a day when we are all back to work?

The last category is wishes and I want to tread lightly here. This is not to say you should write off your goal of a second vacation home, a new car, or a gift to a charity. It is to say that you may need to analyze the importance of that goal and the reasonableness of the timing when you may want to achieve the stated goal. Let’s take the example from before of Jim and Susan. Their investment portfolio was going to be the source of a down-payment on a 2nd home in Newport, RI. It has dropped by 25% because of their exposure to stocks and the general stock market sell-off. Instead of putting $200,000 down, they now have $150,000. Is now the time to make that purchase or should it be tabled into the future? Will real estate prices escalate up at such a rate they will miss out on a current favorable period to purchase? Or will the recovery of their portfolio and real estate’s tendency to follow the stock market down many months after the fact provide a better buying opportunity in the future? How about interest rates, is it likely we will see mortgage rates this low for quite some time? I believe that is likely to be the case. Putting off top of the pyramid needs can be difficult (see Maslow’s self-actualization needs in the chart above), but until we satisfy the more important needs it could be necessary.

PLAYBOOK ACTION STEP #4 (Take Inventory)

There is never a better time to take inventory then before an event occurs that makes it more difficult to track down information. For example, if you experienced a fire in your home, it would undeniably be more difficult to recover important documents and to remember where they were post-fire. If we draw a parallel to financial planning, it is especially important to know what you have, where you have it, and how you go about getting information if needed in short notice. There are plenty of services out there that allow you to secure documents virtually in the cloud, aggregation software solutions that allow you to see all of your assets and liabilities in one place, and programs where you can alert a loved one (often called a deputy in the case of the software I use) about all of your personal, business, and sensitive family information. The fire-proof safe of past generations has been replaced by the cloud, and that is a good thing. In this day of social media, what happens when we are gone? If you think it is as easy as just calling Facebook to delete the profile of a loved one, think again. Here is a list of action steps you should consider now, in no particular order:

1. Consider having a comprehensive financial plan put together that is personalized for you with all of your goals stated.
2. Review your legal documents to make sure they are still relevant…change is a constant, new legislation could render the prior planning obsolete. An example of this is the change to how beneficiaries are treated who inherit retirement assets from a non-spouse. Naming a trust as a beneficiary of a minor child could present problems with the passage of the SECURE Act in the case of retirement assets.
3. Think about your digital footprint and take proactive steps to give someone the ability to sort out your affairs if you are not able to do so. With the changes in the power of attorney capabilities, you may want to see if your power of attorney document would provide for 21st century responsibilities for your named POA. Can the named POA get access to your online passwords?
4. How are your assets titled and what are your beneficiary designations?
5. This coincides with one of the integral steps in the financial planning process but it deserves its own place on the list…create a budget and separate expenses into needs, wants, and wishes. Create a budget for today but one for when you are retired. If you don’t know what you spend, you are flying blindly.
6. Become an expert in your employee benefits available through your employer…I can’t tell you how often I sit with people and they have no idea how much group life insurance they have and what the company provides in terms of retirement contributions. I further suggest you understand your health insurance policy.
7. Ask your financial planner what type of software solution they provide for accessing all of your financial information in one place. Understand the security elements of the software and whether the software allows transactions or not. I would personally not use any software that allows money to be transacted. I much more prefer a read-only software solution with the highest level of encryption.
8. Revisit your portfolio and go through an exercise to determine if your risk tolerance is in alignment with your portfolio composition. Times like the one we are in can try one’s appetite for risk.
9. The one constant we all face to varying degrees is income tax. You need to better understand ways to improve the level of tax you pay now and in the future. It is not what you make, it is what you keep!
10. Lastly, and with no real correlation to the context of financial planning, take some time for self-improvement. Whether that be through expanding your education to further your career or becoming a better spouse, child, or co-worker, I can’t think of a better time for self-actualization. As you may have seen above, that is the top of Maslow’s hierarchy of needs and what we all desire to reach!

PLAYBOOK ACTION STEP #5 (Get Started!)

Thank you for all of you who are out there making a difference. I look forward to returning to life as we once knew it, although it is hard to imagine it will ever be the same. For those who know me, you know I can’t end without a quote from the great Warren Buffet. His picture hangs in my office and I consider him to be the world’s greatest value investor. We should all have a mentor in our personal and professional lives. Age is rarely a limitation.

***“The most important investment you can make is in yourself”***

Take good care of yourself and your loved ones!

Securities offered through Kestra Investment Services, LLC (Kestra IS), member FINRA ([www.finra.org)/SIPC](http://www.finra.org)/SIPC) ([www.sipc.org](http://www.sipc.org)). Investment advisory services offered through Kestra Advisory Services, LLC (Kestra AS), an affiliate of Kestra IS. Kestra IS and Kestra AS are not affiliated with Ridgeline Financial Partners LLC. Neither Kestra IS or Kestra AS provide legal or tax advice.