

What is a financial plan?

I've been in this industry for many years. What I find interesting is that everybody's doing financial planning these days. There are no more stockbrokers or insurance agents, just financial planners or wealth managers.

So that begs the question: What is a financial plan? What does a financial planner produce that is called a financial plan? If you have worked with several financial planners you have seen a financial plan which consists of a binder with many tabs and your name on the front cover.

This financial plan can consist of hundreds of pages and broken into many categories. My clients have given me plans from their previous financial planner and I've read many of these purported financial plans. I have asked my clients, have you read this plan and what you think? Most the time the answer is no I haven't or they have read it and it was too convoluted to understand.

There are dozens of software packages out there that I can buy for a couple hundred dollars, input 10 or 15 data points including your current portfolio and hit a button which would generate hundreds of pages of material which could be segregated into a financial plan. What I really think these software planning tools do is produce an investment plan with a bunch of hypothetical assumptions and cannot take into account all aspects of investments. Those aspects would be:

- short-term versus long-term capital gains in the associated tax ramifications
- if your investments are in an IRA or taxable account
- is your imputed interest rate data point accurate over the life of the investment plan
- what will taxes be while you are in retirement
- how much income redistribution will occur with the tax code, social security payments and the taxability, and the amount you will have to pay for medical care

If you know anyone that has the answers to all these questions please let me know since I do not.

Presently Married and 65

When it comes to investment planning for retirement which I define as; how much money do you need at the point at which you retire and you no longer need to earn income. I try to keep things simple. I assume that you are age 65 when you retire and are married. From that assumption I then looked to the insurance actuary tables and social security tables which suggest that a couple who are presently 65 years old:

- one person has approximately a 40% probability of living to age 90. Take note that is based on today's tables and available medical technology.*
- there's a 72% chance that at least one of them will live until age 85.*

So I try to make it easy. An investment plan with a hundred pages and has a bunch of statistics may actually be significantly off-base. I suggest that at age 65 a person can drawdown about 3% of the principal per year adjusted for inflation. This formula should yield a high probability, not a guarantee, that you won't run out of money.

A financial plan

A financial plan is a result of a thorough analysis of all available data on your financial life. The inputs required for a financial plan could easily be 30 to 50 documents. The amount of time required to read the documents, talk to accountants and lawyers and have meetings with you the client could easily run in excess of 50-100 hours during the first year. The data inputs to be analyzed could include two years of corporate and personal tax returns, your estate plan, all investment statements, all loans, and an analysis of risks and liabilities.

The point I'm trying to make regarding a financial plan is that it takes a lot of time for a senior level person to analyze and assimilate all the information in order to focus on a few strategic areas with the best ROI of your time. The goal is not to take up a lot of client time with what is right, but rather to focus on areas which need improvement. **One part of this financial plan is an investment plan.** The investment plan should have an investment policy statement which is an understanding between you and your investment person on the amount of risk you are willing to take and how much liquidity you will need among many other factors.

I've taken a very short amount of time to explain the difference between an investment plan and a financial plan. So the next time you see a business card with the title "Financial Planner" you should have a better understanding of what that title really means.

Give me a call or shoot me an email if you would like a better understanding of a financial plan vs. the ubiquitous investment plans.

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Derrick received his MBA from Lehigh University and is a Martindale-Rauch Business Scholar. He has earned the designation of Certified Wealth Strategist.

After college he spent 3 years in the pharmaceutical industry and then went on to run and own several businesses including Handwerk Multi Family Office.

Handwerk Multi Family Office works with small business owners and families who are affluent. Over 50% of his family office clients are physicians.

Derrick is available to speak at regional or national events and many of the articles he publishes are a result of questions or issues sent in by readers via email. Please email financial questions or requests for speaking engagements to derrick@handwerksmfo.com.

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Data extracted from: Analysis of 2007 period life table for social security area population

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