The Pyramid of Financial Success

When we talk to clients about financial planning, it is all about you and not generic.

The process of providing a financial services guide is to let you know how we provide advice, what we charge and what the financial planning process is. This includes reviewing your current situation, providing you with a written advice document and setting up a long-term support strategy to help you reach the specific advice outcomes you sought.

On occasions it is good to look at advice from a generic viewpoint, and this can help look at the financial planning process from an aerial viewpoint.

If we use an investment pyramid it is important to understand your top priorities at the base of the pyramid.

It may look something like this.

The base of the pyramid is to actually set a financial goal.

A lot of people start a day with a to-do list.

We all get interruptions and these include phone calls, answering emails, reading our newsletter that just popped in to your email box, chatting with colleagues and all of a sudden, the day is half gone.

Trying to build and protect wealth without defining long-term goals is similar. Rather than just having a goal of 'wealth accumulation', take a step back and articulate the specifics of what you're trying to achieve, when you'll need the money, and how much.

Is it building a nest egg for children's education? is it ensuring you have enough capital to have the same or more income in retirement than when you are working, do you want to buy a bigger house within the next five years?

Only you know, and this is what we believe should be the base of a financial pyramid.

The next band: managing your saving and spending

The second level of the pyramid is the hard stuff.

Many planners call it paying yourself first, others call it budgeting, whatever the terminology it is boring, requires discipline, desire and dedication to a goal.

It is easy to put it off, and you'll be hard-pressed to make up for a shortfall if you haven't saved enough. This is key to ensure that your savings rate puts you on track to achieve the above-mentioned goals. This concept matters long after you've stopped saving, too.

Retirees are obsessed with the topic of spending rates and for good reason. The difference between a 4% and a 6% withdrawal rate can be enormous when it comes to the viability of a retirement plan - especially when interest rates are so low.

Choosing your asset allocation

Once you have decided to set a goal, and have determined how to save for that goal, the next key to a sensible financial plan is to get the right asset-allocation mix for you.

A portfolio that consists entirely of cash and short-term bonds will exhibit very few fluctuations but when interest rates are as low as they are today, it is hard to get the benefit of compounding. Cash in this environment is peace of mind and to fund very short-term goals. Over time, however investing in cash in the present market is an investment in wealth reduction.

Your ability to accept risk differs and getting the correct asset allocation is paramount to your returns. It is not up to your planner to define how much risk you should take, but a combination of education and understanding to match your risk appetite to the appropriate mix of investment thematic that will deliver your best outcome.

The achievement of long-term goals is all about getting the asset allocation right for the time in the cycle you invest. The more time you have, the greater risk you are capable of taking. In financial planning time is the thief of performance. Success is more about time in, not timing of investment.

Managing your own behaviour

On the point of time in, rather than timing, managing behaviour is so important.

We know fear and greed cost the majority of investors. Most people buy when markets have already risen, and sell when they fall. The customer with a goal, a savings plan, the correct asset allocation can reduce the fear and greed factor if it is correct for your risk profile.

Many financial advisers say one of their most important contributions to their clients' financial well-being is to help them manage their emotions and stick with their plans through good and bad market environments.

It's important to identify and manage your own potential behavioural hang-ups, such as a tendency to be too risk-averse for your life stage or to have more confidence in your investing abilities than is warranted.

Tax efficiency

Many advisers focus on tax efficiency ahead of the other levels of the pyramid, and this is not efficient.

Paying too much tax is dumb, but also investing for tax only reasons is dumb. Paying attention to tax efficiency encompasses a very broad and important set of issues, including taking advantage of tax-advantaged superannuation accounts, using low turnover funds, proper asset location, and employing tax-efficient withdrawal strategies during retirement is sage.

In fact, tax-efficient decision making is one of the key factors that add value in the financial planning process. This is where you talk to us, but getting the first part right comes well ahead on how to pay less tax. One way of paying less tax is losing money.

Investment selections

The selection of the investments is our last function. When you do not see us, we are busy meeting fund manager after fund manager, insurer after insurer, bank after bank to understand one investment product against another.

In our case we have over 3000 investment funds to select from that are approved by our investment committee as well as access to every life insurer. You do not need to know the difference between each because that is a part of what we offer to you.

To determine which manager or insurer product best serves your risk profile and needs. This for you is the least important albeit often the fun stuff and why we have seen so many move to manage their own self-managed super funds or portfolios.

The investment selection placement does not form the basis of the advice. The advice is the understanding and assistance in setting of goals, understanding how to budget to save for them, establishing the right asset allocation, ensuring the investments are tax effective and then finally choosing the investments, insurance and product strategy that is in your best interest.

We know there's a big difference between investing with a high-quality fund than a C-list fund but for us that is the easy part. We already know these answers and are impartial to this part of the process. Investment selection appears at the top because it needs to be informed by the factors beneath it in the pyramid.

It's not always the case that tax considerations will trump your investment selection, but taxes should be an input in what securities you choose, as should your allocation needs, your expectations for the investment (having the right expectations should ameliorate bad behaviour), and the rest of your financial plan.

Once those factors point the way toward a certain category of investments, you can then look at fees, management, and other investment-specific hallmarks of quality.

Review

Often on reading the process once again, you may wish to do a further review your current circumstances.

If you do, give us a call and we can sit down to discuss your very own pyramid.