Wealth Wise

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Gigo: where financial plans go wrong

Done well, and a financial plan should create confidence and lead to far better decision making. Done wrong, however, and it can have dire financial consequences that could lead to people running out of money before they run out of breath. This is not an outcome that we will ever tolerate our clients having to deal with.

A financial plan is clearly dependent entirely on the numbers that are input into it. After all, it is nothing more than a complex spreadsheet. And, like with any spreadsheet, it is crucial that the numbers entered are correct. You may be familiar with the term GIGO (Garbage In, Garbage Out), which is a harsh way of highlighting that if the input numbers are wrong even a relatively small error can have disastrous consequences when compounded over time.

Most of the numbers required to create a financial plan are factual. However, there are two major areas that are down to clients to get right. These are often dramatically underestimated and so I'd like to take a deeper look at the importance of expenditure and longevity.

Longevity

Let's consider longevity first. The chart over the page shows that a male aged 65 has a 1 in 10 chance of reaching 97. This is a staggering number. Whilst current life expectancy has stagnated and has recently gone down, it is not unreasonable to assume that in the future this is likely to increase through medical

advancements. But as individuals, we somehow don't believe it will affect us.

I have never met a client who believes they will live to 97. I'm not sure if that's because we simply can't see that far ahead or if we just perceive being that old as being infirm. We simply don't want to believe that it will happen to us.

Let's look at the number a different way. We could take a leap and say that 1 in 10 of our clients have a chance of reaching 97, with 1000 clients that means 100 will reach that age. It's also important to remember that these are average figures covering the population as a whole, yet our clients are in a socioeconomic group that benefits from a better diet, healthcare and standard of living as a result of their financial standing. Therefore, they are likely to have a substantially increased life expectancy.

My first conclusion is that we therefore need to run financial plans to these extreme ages to check that everything still works and then amend the plans if necessary.

My second is that even a 75-year old potentially still has a 30 plus year investment time horizon and therefore reducing risk as age increases can be a damaging thing to do. I often hear clients say, "at my age I can't take a long-term view" and yet often that's exactly what they need to be doing.

Your average life expectancy is...

86 years

(that's **21** years from now)

However there's a chance you might live longer...

1 in 4 chance of reaching

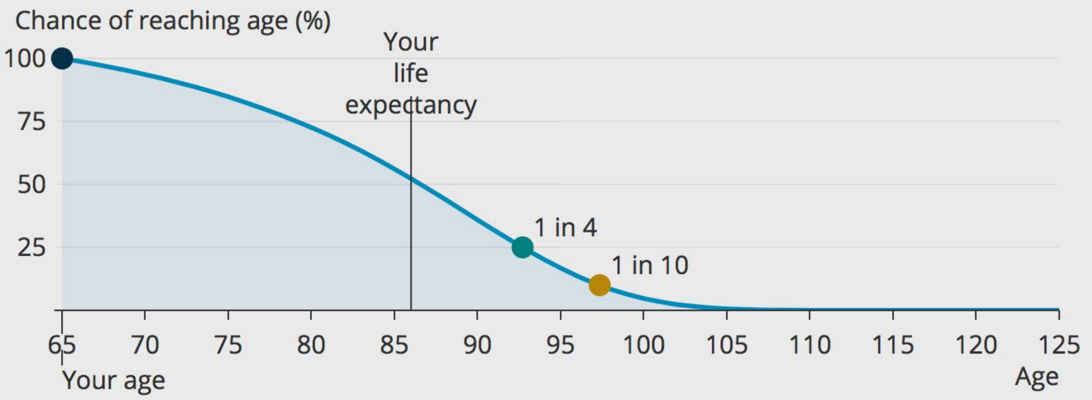
93

1 in 10 chance of reaching

97

Chance of reaching 100

4.7%



Source: Office for National Statistics

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Expenditure

Expenditure is a funny old thing as it's something that we do every day and yet we pay little attention to it. And when we do focus on it, we all have a strong tendency to miscalculate.

That may sound harsh as most clients actually have a very good handle on their "ordinary annual expenditure". However, it's the "exceptional expenditure" that we tend to at worst ignore and at best underestimate.

I recently had a five-year review with a client where their expenditure had been 30% higher than planned pretty much every year since we had been working together. At each annual review, we would set their monthly withdrawals to meet their normal living expenses but then at some point every year they would request a one-off withdrawal for an "exceptional" item.

At the recent meeting we analysed all these expenses and it quickly became clear that whilst exceptional, they were also predictable and would continue to reoccur. Examples of these include:

1. **House maintenance** (the essential things that need doing from time to time)
2. **House refurbishment** (the new kitchen, bathroom, wall paper etc)
3. **Car replacements**
4. **Assisting children when further assistance wasn't planned**
5. **Unexpected medical bills**
6. **A large holiday to celebrate an event**
7. **Becoming captain of the golf club**

Some are more difficult than others to put a figure on but there are others that we can help with. For instance, I estimate that you need to spend an average of 1% per annum on the property for maintenance and refurbishment.

So, on a house worth £600,000, that's £6,000 pa. If you have two houses you need to include both. You may think that number is high but if you had spent nothing on a house of that value for two decades, then £120,000 would be a reasonable figure to bring it up to date.

That may still seem a lot! However, a simple test is to stand at the drive, estimate its replacement cost, replacement date and then average out the figure. Repeat for the roof, the windows, the gates, the kitchen, the carpets, the bathroom etc and just keep going. The number may surprise you!

We think financial confidence is so important that we will shortly be categorising clients based upon their own personalised financial plans. We will be ranking clients as secure, comfortable or vulnerable before having a full and frank discussion around what this means.

It could be that we rank a client as vulnerable to stock market falls and therefore we need to ensure their portfolio remains cautious. We could say that they are vulnerable to over spending if their planned expenditure is close to their upper limits. In this scenario we would have to pay extra attention to the potential impacts of inflation.

A financial plan is a very powerful and positive tool that will hopefully give most clients the confidence to spend and/or give more away. It's our responsibility to create financial plans robust enough to adapt to anything that life or the markets can throw at us.

I hope you've enjoyed this issue of Wealth Wise. Next time I will be looking at what to do with those surplus assets your plan has highlighted and the power of compound growth on tax relief.