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Plan to Win

Avoid the 5 most common planning pitfalls

Everyone agrees that financial planning is important. But actually developing and putting a plan into action is another story. Because planning can be time-consuming and force families to deal with difficult questions that are more easily ignored or delayed, it often slides down the list of priorities.

But planning is worth the effort. Individual and family finances have many moving pieces – income, real estate, credit, business interests, hopes for college, lifestyle aspirations, retirement plans, philanthropy, and taxes, to name a few. It's a lot to ask for all these moving pieces to magically fall into synchronized motion like the inner workings of a watch. Trying to operate without the benefit of planning invites poor, and possibly disastrous, results.

Those who do create plans face potential challenges and pitfalls, too. Here are the top 5 scenarios to avoid:

1. Starting late

The oldest rule in the book is to start planning as early as possible. Starting at 35 is better than 45 or 55, and 25 is better still. The magic of compounding rewards those who start saving for college when the kids are still in diapers, and open retirement accounts on the first day of eligibility.

The math is compelling. A 25 year-old investing \$10,018 annually and earning a 7% annualized return will accumulate \$2 million by age 65. To reach the same \$2 million level at 65, an investor who doesn't start until age 45 would need to put away more than \$48,000 each year.

Happily, for those who start early the planning process can be a relatively simplistic regimen of regularly funding an IRA or 401k account, with additional elements and strategies added as one's goals, family, and income grow.

2. Creating multiple, unconnected plans

In many households, financial planning occurs on a squeaky wheel basis, where a specific financial need or goal nags for and eventually receives the attention it demands. This ad hoc approach typically results in a mismatched array of plans, each assembled independently by a different specialist.

While each plan may meet the immediate need, over time the pieces may fail to mesh. For example, investment accounts and insurance policies often create redundancy in goals and unnecessary duplication of costs.

Looking at disparate planning elements together, rather than independently, is both more efficient and more effective. Important life events such as marriages, births, and new business formations, among many others, provide ideal opportunities to not only consider new wealth planning needs, but to confirm that existing plans are working cohesively.



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3. Building – and forgetting – a giant binder

Assembling a comprehensive, cohesive financial plan is a big job. To craft a viable plan that addresses savings, spending, investment, taxes, insurance, education, estate planning, and philanthropy requires serious discussions, careful thought, and tough choices.

Frankly, financial planning wears a lot of people out. This may explain why so many thoughtful plans end up largely unimplemented – impressively fat binders collecting dust on a shelf. A plan without action is all pain and no gain. Even implementing different pieces of the plan over a five period is far better than implementing none of it.

4. Relying on false assumptions

Every plan requires assumptions about the future. Trying to “make the numbers work” by using faulty assumptions can lead to serious problems down the road.

For instance, many investors overestimate the returns they can expect to achieve. This can lead to major shortfalls. In the example above, a 25 year-old seeking to reach \$2 million by age 65 and expecting a 12% annualized return would put away just \$2,607 per year. If the actual return is not 12%, but a more reasonable 7%, the nest egg would grow to only \$520,000.

Other suspects for garbage-in/garbage-out include assuming that markets will repeat recent performance year after year; not factoring in taxes or inflation; placing too much faith in future Social Security benefits; and trusting rules of thumb, for instance, that a couple can retire on just 60% of their annual working income without lowering their standard of living.

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Assumptions must be made in any wealth planning activity, but erring on the conservative side is preferable to creating a rosy, but unattainable, forecast.

5. Putting other goals ahead of retirement

Retirement can seem so far off in the future that it takes a backseat as other more immediate financial issues are handled. Funds may be allocated to an overdue home renovation, private elementary school, a vacation home, or other worthy causes, while little or no money goes into retirement accounts. With individuals living longer than ever, the consequences of delaying retirement savings can be devastating.

Like it or not, retirement is expensive, and every dollar spent today reduces what’s available later. Consistent retirement savings should be part of every financial planning decision. Many families find it useful to think of investing for retirement as a mortgage – a long-term obligation where regular payments yield the desired outcome.



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The roles of the advisor

A financial advisor can help avoid all of these pitfalls, and others. The advisor can play many roles in the planning process, from educator and catalyst, to coordinator of multiple specialists, to a valuable voice of reason regarding goals and assumptions. The advisor can also spearhead the important transition from the development of a plan to its implementation and maintenance over time.

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