

Failing to Plan is Planning to Fail: The Need for a Lifetime Cashflow Analysis

As you pass through different stages of life your circumstances and priorities will change. However, if there is one certainty it is that the future will remain uncertain. No-one can predict what is going to happen in future years and we are surrounded by uncertainty in our lives. We often hear questions such as these from clients:

- I don't know whether I can afford to retire?
- I want to reduce any inheritance tax on my death, but don't want to reduce my current or future standard of living.
- How much can I withdraw from my investment portfolio and still maintain its value?
- I wish to be in a position to retire from age 50, how much do I need to save?

These questions are not unique to any client, but the answers will depend upon the client's unique situation, lifestyle goals and preferences – there is no one size fits all answer. Without a personalised framework developed to meet your specific requirements, how can you determine what is good and bad advice for your situation? It is a bit like your health – just being told not to smoke or what to eat is not enough. We need to understand the implications of our health choices before we change our behaviour.

No matter how technically sound an investment strategy is, or how well a superbly crafted investment portfolio performs, if you do not understand the implications of your financial decisions, you are unlikely to achieve your goals, or if you do it will probably be achieved through chance alone.

All financial decisions should start with a thorough understanding of your goals and objectives. How can you work out how you're going to structure your finances without knowing what you want to achieve?

Secondly, you need to consider what your existing financial situation is and whether you are likely to meet your stated objectives. Unfortunately, this is where most people encounter the main problem – they have no idea of their existing resources or what these will be in the future. Companies have utilised balance sheets, profit and loss statements and cashflow forecasts for many years – why can't these concepts be utilised for individuals? Well they can. This is where a *Lifetime Cashflow Analysis* comes into a class of its own. Using this planning technique, allows you to take all your current financial resources, investments, pensions, business interests etc, and project forward a view of how your financial future will look. A *Lifetime Cashflow Analysis* is only as good as the people using it – it's your plan so you should be integral to its formation – you should be happy with any assumptions utilised and use your financial planner's knowledge to educate you on the options.

The major benefit of complete quantification is the determination of whether you are on target to achieve your financial goals, and if you are not on course, then how far off course are you, and what can be done to get back on track before it's too late. By evaluating the plan as time passes you are in full control of your financial future, and are empowered to make the decisions that matter. Financial planning is a dynamic process, circumstances change sometimes for the better and sometimes for the worse; a *Lifetime Cashflow Analysis* ensures that your investment portfolio is always attuned with your financial goals throughout your changing life.

Now let us look at a specific example of the importance of a *Lifetime Cashflow Analysis*. This married couple wished to retire early, maintain two homes and required a net annual income of £50,000 for the rest of their joint lives. They wanted to travel extensively in the early years of their retirement, but were also very concerned about the potential costs of long-term care. Over 80% of their liquid assets were in deposit based savings. Chart 1 details the expected value of their liquid assets based upon the £50,000 of net annual expenditure (in today's terms) through the remainder of their lives, based upon maintaining their investments in their current format. This shows that their investments would be completely depleted by age 84. This would leave them with having to reduce their outgoings considerably and leave them dependent upon selling their home to meet long term care costs if that eventuality arose. This was not a position they wanted to be in.

Chart 1: Net annual expenditure of £50,000 per annum: Value of Liquid Assets @ 3.5% growth

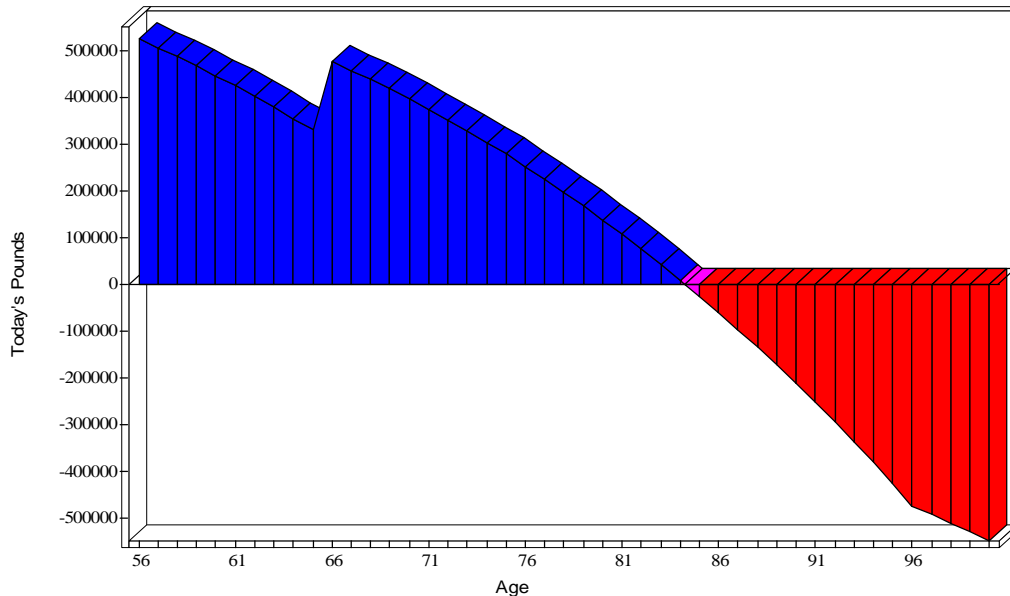
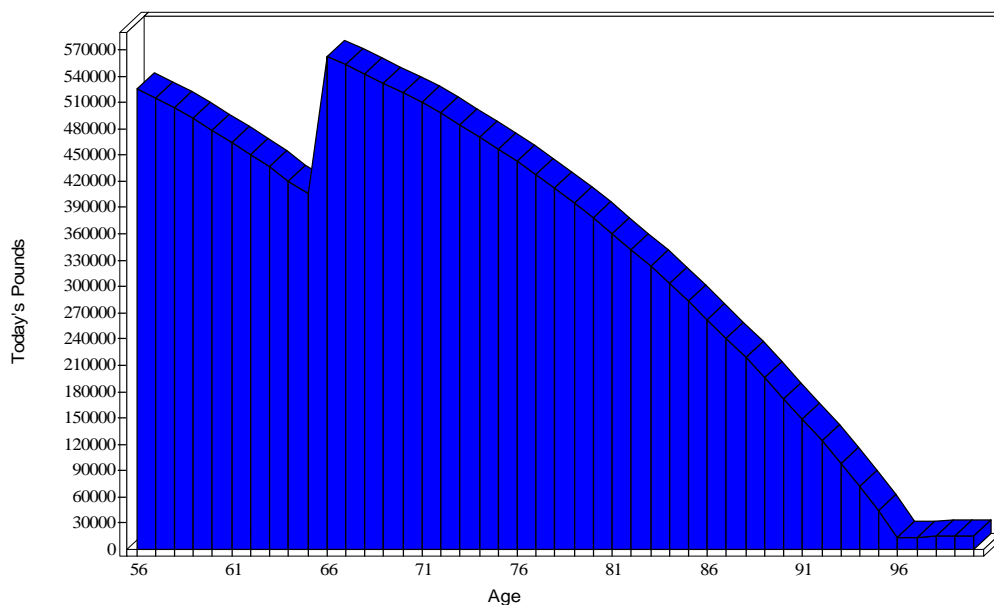


Chart 2 details the position if they were to earn a net return of 5% per annum on their investment portfolio. This shows that their portfolio would only be depleted by the time they reach age 100, and provides much greater security. In this case the 5% required rate of return was achievable bearing in mind their risk tolerance and timescales, and the client opted to amend their portfolio to target the 5% return.

Chart 2: Net annual expenditure of £50,000 per annum: Value of Liquid Assets @ 5% growth



If the required rate of return would have required a portfolio of too high a risk level, the clients would have had to consider some tough decisions. Their options would have been:

- Lower their expenditure requirements either now or in the future.
- Go back to work to earn and save further monies to meet their required expenditure expectations.
- To accept the necessary portfolio, even though its risk level was in excess of their acceptable limit.

Importantly, the choices and implications of making each choice can be clearly shown and the planning process often involves much scenario modelling before clients are completely happy with how their financial future looks. In the above case, the clients could afford to amend their portfolio's asset allocation because they had planned early enough, if they had left things another ten years, then their options would have been much more restricted.

Conclusions

Whatever the stimulus for seeking financial advice, an upcoming retirement, inheritance tax mitigation or investment planning, there is no need for financial affairs to be structured in an ad hoc and imprecise manner. Used correctly, a *Lifetime Cashflow Analysis* should form the focal point of your planning and provoke discussion, analysis and evaluation of your goals and objectives. It allows you to understand the implications of your financial choices so you can make decisions based upon accurate calculations rather than rely on the 'finger in the air' and 'blind faith' approach so often utilised in the financial world.

Trying to establish and manage an investment portfolio without knowing what the minimum rate of return required for you to meet all of your future financial objectives, involves pure speculation. In this modern age there is no need to take this unnecessary risk. If you do, then it is likely that you will end up with an 'off-the-shelf' model portfolio which has been structured with little regard for your personal situation, and is highly unlikely to exhibit the risk reward characteristics necessary for the successful achievement of your objectives with the minimum chance of failure.

The message should be straightforward, ensure that you utilise an investment manager who has the skills, technology and application to build a *Lifetime Cashflow Analysis* into their investment planning process – anything less is to accept a poor second-best.

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