Be Flexible in Your Financial Planning


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>> In virtually all aspects of life, we recognize the importance of flexibility. When it comes to long-term financial and retirement planning, however, many individuals, families, and even some businesses rely on static, set-it-and-forget-it plans.

Ahead, we examine flexibility as a key component of achieving long-term financial success and building an individual retirement plan. The following financial elements should each incorporate a level of flexibility. Let's take a look.

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INCOME AND CASH FLOW CHANGES

Few of us can accurately predict our future incomes, so flexibility must be part of retirement planning. How can individuals incorporate income and cash flow in their planning? Living below one's means and prioritizing saving (each month, quarter, and year) is fundamental to weathering any temporary or even long-term hits to income and cash flow.

Another tactic is the implementation of a savings vehicle that allows uneven funding or investment from year to year. In the area of qualified retirement plans (QRPs), one example would be a defined contribution plan that allows flexibility in individual contributions each year. This is in contrast to defined benefit plans, which require a certain level of funding and can entail underfunding penalties. More relevant still are nonqualified plans, which allow much higher contributions than defined plans when an individual's income is high but can be skipped entirely during years in which income wanes.

Another asset class that allows flexibility is permanent life insurance—specifically, a policy that has the benefit of tax-deferred growth and asset protection. In universal life policies, funding can be flexible from year to year, unlike whole life policies, for which funding must occur each year.

CHANGES IN TAX RATES

Significant changes to the tax code in 2017 and 2018 underscore the importance of flexibility in retirement planning. Taxes will continue to change, and tax rates may look very different in 10, 20, or, 30 years. A "tax diversification" approach can help alleviate potential future issues. Many financial planners advocate diversification of asset classes among investments, but it is equally crucial to diversify the tax rate exposure to one's wealth.

When we look at investment plans from the perspective of tax diversification, we see that most investors have inadequate investments in asset classes or structures that will be immune to future increases in income or capital gains taxes. Assets such as cash-value life insurance, tax-free municipal bonds, Roth IRAs, and other vehicles should be part of any wealth-building plan.

The bottom line is that individuals need to have enough flexibility to be prepared for the possibility of tax rate changes during their investment timelines, for better or worse.

CHANGES IN THE MARKET

By "market," in this context, we mean more than the small sample of the stock market in the United States that is represented by the Dow Jones Industrial Average or even the S&P 500 index. There is volatility in all securities, commodities, real estate, and other asset marketplaces domestically and internationally. Values in all classes often go up, but they also come back down.

Savvy investors understand that portfolio diversification is key to reducing portfolio risks. Rather than staying within a specific area, such as securities or real estate, diversification must cross investment classes, especially in a volatile market. A balance of asset classes—

international and domestic, traded and untraded, correlated to markets and noncorrelated—constitutes a flexible long-term approach.

CHANGES IN LIABILITY

Any planning designed to shield wealth from a legal claimant, creditor, or even a soon-to-be-former spouse is typically not effective if it is implemented only when the threat becomes reasonably foreseeable. That is to say, asset protection planning must be put into place before there is a problem. The challenge is that the individual wants to maintain ownership of, control of, and access to his or her assets at times when there is no looming liability threat.

Fortunately, with comprehensive asset protection planning, utilizing exempt assets, legal tools, insurances, and proper ownership forms, these goals can typically be accomplished. Individuals can generally build flexibility into financial plans using tools that protect wealth if and when there are liability threats but still allow ownership, control, and access to that wealth when the coast is clear.

CHANGES IN HEALTH

Health is the single most important element in planning. At one extreme, being in good health is a blessing that allows individuals to be more productive, to create more wealth, and to enjoy it. At the other extreme, poor health can keep individuals from earning a living and even lead to premature death, which can have a devastating economic impact on the surviving family. Because of this, it is imperative that a conservative wealth plan take potential changes in health into consideration.

Both disability and life insurance are essential. Securing the proper insurances protects an individual's ability to earn, with options that provide a regular income stream in the event of disability and offer financial protection to heirs in the event of death. According to a 2013 U.S. Social Security Administration Fact Sheet, just over one-in-four of today's 20-year-olds will become disabled before they retire. The same Fact Sheet notes about 100 million American workers are without private disability income insurance. This presents an obvious financial risk.

Life insurance coverage is needed not only if one has concerns about meeting individual financial goals, but also if these concerns apply to the financial welfare of one's family. There is a variety of life insurance products, from term to cash value and from whole life to private placement.

Whatever product is chosen, planning is needed to assure adequate coverage given one's income, debt, assets, family situation, tax rate, state of residency, and goals. These are typically analyzed on a case-by-case basis depending on one's situation.

PLANNING FOR THE FUTURE

The sooner an individual starts to plan for the financial future, the better off he or she will be. The elements of individual plans will differ; circumstances such as age, income, and goals will dictate what must be emphasized. It's important to get started sooner rather than later and build some flexibility into the plan to remain as prepared as possible for changes down the road. ■

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