

The 7-Financial Planning Traps To Avoid

#7PW: Financial Planning Wednesday



Financial planning gets a bum rap. Or no rap at all. After all, the process lacks excitement. There are none of the day-to-day highs and lows of the stock market. No sizzle. Financial planning doesn't make headlines or capture the attention of media talking heads. It flies under the radar. And to that I say: Thank goodness. As a saver and investor, financial planning should be at the top of your list of tasks to accomplish. Consider financial planning a mundane sentinel which forms the foundation of money awareness. When plans are attached to goals or life benchmarks as I call them, they take on a life of their own as progress markers along the path to a successful financial life. A plan is a complete diagnostic of money chemistry. And the numbers don't lie. At times, it's validation, other times, an awakening. On occasion, a warning.

See? Perhaps planning is exciting (we'll keep that between us. Our own little secret).

Now that I have your attention and you're ready to go, I'll share seven huge mistakes I've encountered with the planning process over the last two decades.

You depend on the wrong tools to get the job done.

Online publicly-available financial planning calculators are the junk food of finance posing as nutritious choices. I guess it's better than nothing, however just because a planning calculator is available from a reputable firm like Vanguard or Charles Schwab surprisingly doesn't make it worthy of consideration. **As a matter of fact, per a recent [study](#), the efficacy of publicly-available retirement planning tools from 36 popular financial websites was challenged and results were extremely misleading.** These quick (worthless) financial empty-calories don't provide enough input variables to provide a level of accuracy. Most egregious is the dramatic over-estimation of returns and plan success. If you trust an online calculator to adequately plan for retirement or any other long-term financial life benchmark, and feel confident in the output (most likely because it provided a positive outcome,) then you're ostensibly setting yourself for dangerous surprises. Avoid them. They're not worth it. Best not to do any planning at all if it's this route.

You haven't undertaken a comprehensive financial diagnostic.

According to the 2013 Household Financial Planning Survey & Index prepared for the Certified Financial Planning Board of Standards, only 19 percent of 1,000 household financial decision-makers had gone beyond a simple household budget when it came to planning. **A properly designed financial plan will cover important elements like retirement savings, insurance analysis and estate review; a qualified planner will target and outline specific areas of strength and weakness along with flexible, realistic routes to each financial goal.** If you're stressing over the process, how long it takes to get a plan together: don't. Yes, there's a financial self-discovery period on your part and that will take effort and homework. However, a plan can be modular based on your most important concern first, then built on over time.

You employ a broker to handle planning responsibility.

You're best to seek out a fiduciary, a professional or an organization that places the clients' interest first. **Planning isn't a big attention-getter, especially at brokerage firms. It isn't a profitable venture as it directs attention and resources away from activities that generate revenues, like selling products. If anything, it's a loss leader. An afterthought.** To maintain an image of care or come across as "consultative," financial plans are offered but they're not a focus. They're employed as a method to discover where assets are and where opportunities lie to generate sales. This is not what planning is supposed to be. The process minimizes the importance of building, maintaining and monitoring a holistic financial plan. A plan must be taken seriously and not considered an afterthought. Recently, Antoinette Koerner, a professor of entrepreneurial finance and chair of the finance department at the MIT Sloan School of Management, along with two co-authors, set out to analyze the quality of financial advice provided to clients in the greater Boston area. They employed "mystery shoppers" to impersonate customers looking for advice on how to invest their retirement savings. Unfortunately, it didn't work out too well. **Advisors interviewed tended to sell expensive and high-fee products and favored actively-managed funds over inexpensive index fund alternatives. Less than 8% of the advisors encouraged an index fund approach.** The researchers found it disconcerting how advisor incentives were designed to motivate clients away from existing investment strategies regardless of their merit. They found that a majority of the professionals interviewed were willing to place clients in worse positions to secure personal, financial gain. So, let me ask: Would you rather have a

comprehensive plan completed by a professional who adheres to a fiduciary standard where your financial health and plan are paramount, or a broker tied to an incentive to sell product? Brokerage firms are willing to offer financial plans at no cost. However, the price you'll ultimately pay for products and lack of objectivity, is not worth a "free" plan. It's in your best interest to find a financial partner who works on an hourly-fee basis or is paid to do the work, not investments sold.

Your portfolio revolves around the plan & not vice versa.

Let's face it, and I've mentioned it previously: Planning is boring, investments are exciting. There are investors who believe that if they can consistently achieve greater than market returns, then the rest of the plan will follow suit. Not really. A "returns first" perspective will place a plan in jeopardy as taking on additional risk will likely not lead to commensurate returns, especially if not backed by an aggressive savings and debt management strategy to provide a cushion against market losses. The genesis of an effective financial plan begins with the prioritization of personal goals broken down by needs and wants along with the rates of return required to meet them. **The rates of return should be considered a blend of market performance, your personal savings rate and a willingness to increase savings during times of below average or poor market performance.**

So, let your plan drive required returns and work with an objective pro who can mesh return expectations with current market reality.

You believe plan results are written in stone.

I need you to believe your plan is formed of mud and clay. A financial plan represents a human life with a path far from perfect. A plan is supposed to be molded, changed, pushed, pulled and on occasion, downright messy. Even if you're disappointed by the outcome (*your financial resources won't go as far as required, or there's compromise on certain wants*), **a financial plan should always be based on optimism and a strategy to improve thus the push/pull. You push habits that require improvement, pull from expectations to create results you can live with.** If planning starts early, say, 5-10 years from the goal, you can rein in weaknesses and switch gears, make positive changes that will have a formidable impact. The plan should be a revelation; a level of financial alertness that goes a long way to expose flaws, identify strengths and generate ongoing dialogue about current and future lifestyle decisions.

You discount luck in the process.

It's the spin of a roulette wheel. Where the results of your goals and market returns intersect is pure luck. Will you experience a great tailwind of investment returns that enhance your outcome? Or is a headwind on the horizon which requires an increased savings discipline or more focus on a return of your human capital (income potential). For example, based on current stock valuations, there's an above average probability that a retiree will face a prolonged, low-return headwind which will require ongoing monitoring of expenses and portfolio withdrawals at the least, every three years. Bad luck in the form of a poor sequence of returns or above average inflation can lead to premature portfolio depletion. In other words, you may outlive your money!



The alignment of investment returns to the accomplishment of a financial goal within a specific time frame is a random and occasionally frustrating event. Never discount how ?being in the right market cycle at the right time,? makes a tremendous contribution to your success. It?s best to understand this concept of luck before planning begins. It?ll keep you grounded and aware of your savings, investment and debt habits post-plan improvement/monitoring stage.

Your plan investment return estimates are too optimistic.

To a broker, flat or bear market cycles don?t exist. He or she has been trained by an employer to believe stocks perpetually go up. It?s the greatest wide-spread alternate-reality ?fact.? You?ve heard and read how markets have reached new highs (17 years), and it?ll be shoved in your face that markets always move higher (17 years). Did I mention it took 17 years? What?s 17 years? To you? To me? An eternity. To the market? A blip. • We?re advised how it?s one big bull market party and it goes on forever.

How dare you miss the fun?•

Realistically, the dogma is false narrative. If you fall for it, you may wind up spending an investment life making up for losses or breaking even. Most financial planning software generates outcomes based on something called ?Monte Carlo? simulation. It?s as close as planners get to represent the variability of market returns over time. **Monte Carlo generates randomness to a portfolio and simulates, perhaps thousands of times, around an average rate of return. Unfortunately, asset-class returns most Monte Carlo tools incorporate tend to be optimistic.** In addition, even though Monte Carlo simulates *volatility of returns*, it does a very poor job representing sequence of *returns* which I think of as a tethered rope of successive poor or rich returns. Per friend and mentor Jim Otar, a financial planner, speaker and writer in Canada:

?Markets are random in the short term, cyclical in the medium term, and trending in the long term. They are neither random, nor average, nor trending in?all?time frames. Secular trends can last as long as 20 years (up down or sideways). The randomness of the markets are piggybacked onto these secular trends.

Assuming an average growth and adding randomness to it does not provide a good model for the market behavior over the long term and it makes the model to "forget" the black swan events.?•

It?s why at Clarity, as a backstop, we employ various planning methodologies which incorporate how market cycles operate and where your goals may fall within them. Look for an upcoming interview on Real Investment Advice with Jim. Consider financial planning as the ultimate uneventful main event. Granted, a comprehensive plan experience won?t be the talk of your next cocktail party. However, it just may allow you the freedom and peace of mind to enjoy the benchmarks you work hard every day to reach. And that?s worth more than money to you and your family.