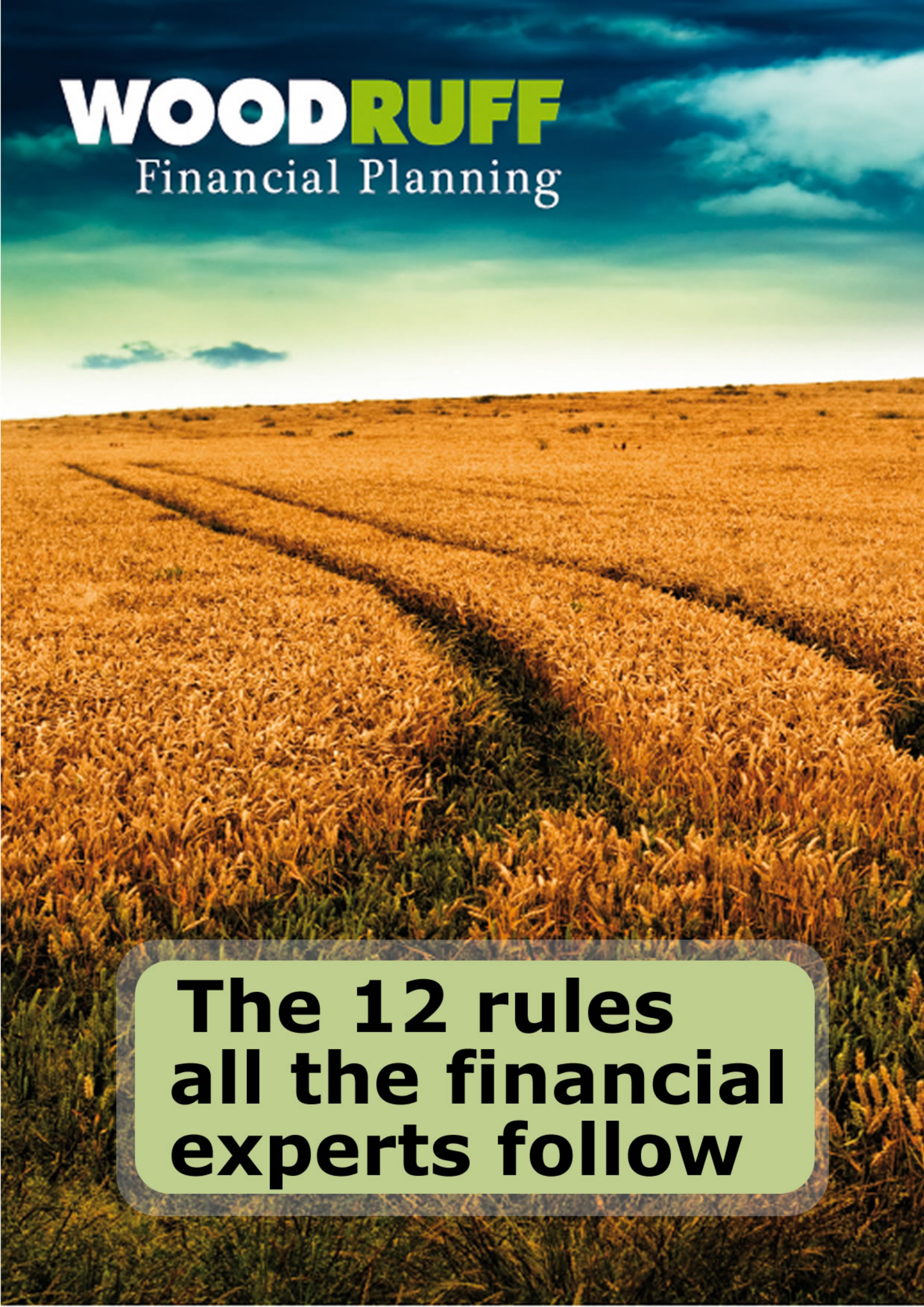
WOODRUFF

Financial Planning



The 12 rules all the financial experts follow

Contents

1. About this guide

This guide is all about helping you to become financially independent. It contains scores of sensible and easy to follow financial planning tips based on fundamental principles developed with experience by financial experts.

We work with people like you who have taken the first step to understanding the truth about their money, and who want to take control over their future lifestyle.

This does not contain all the answers, just a range of areas which we think you really need to think about to start you on your journey. This list is not exhaustive, but does contain what we think is most important. If you want to give us some feedback, our details are at the end of the document.

2. Why your financial adviser was wrong – why should you consider making a financial plan?

Do you know the truth about your money? A financial plan can help you to get answers

Financial planning should help you to develop an objective plan for your financial future. You should follow these principles to ensure that every aspect of your financial life is covered, and therefore build a solid foundation to meet your lifestyle expectations.

Your goals will depend on your own personal situation and what you want to plan for in the future. For example, you might want to plan for retirement at a certain date, buy a second home or send your kids to private school. The list is only limited by your imagination. It is not just about the financial side either; you should also think about what is important to you to achieve in your life.

This is all based on a common sense approach. Anyone can do it; you just need to be methodical and objective.

What about financial advice?

Unfortunately, most financial advisers do not offer comprehensive financial planning. Most of them are glorified sales people. This is proven by the fact that they usually sell you products as solutions rather than helping you to understand the ramifications of your financial decisions.

If your financial adviser starts by talking about products he is thinking about himself rather than your future!

Of course, there is a place for products, but only at the end of a comprehensive analysis of the reasons why you need that solution. What's more your financial plan might reveal that you do not need further products! In our experience, none of our clients actually care whether their assets are businesses, property, investments, pensions or anything else you can think about. What they really care about is what those assets mean for their future lifestyle. After all, these assets are only worth something if they can help you to live the life you really want, or they can help you to fund that lifestyle. Whether you have the latest features is not as relevant (although could be important).

Who is this information designed for?

In short, everyone who is interested in becoming **financially independent**. To us, that means being able to choose to stop work and start doing the things you really want to do. Note that we say having the ability to choose to stop work. For some people, the work is what drives them; for others it is the ability to do the things they want in their life. It is different for everyone.

If you read all this information you will have a good basis to go away and prepare your own comprehensive financial plan. Of course, you may decide you can't be bothered with all that, and if that's the case (guess what) that's how we make our money. We help people like you to develop financial plans to help them overcome all sorts of financial hurdles.

3. Inaction will mean you fail to achieve your dreams – why you need a financial plan

Getting real control over your life

Financial planning is about breaking your financial life into manageable chunks so you can make progress in all of these. Your financial plan will allow you to prioritise your needs, so that the most important are dealt with first.

Achieving your goals faster

Your financial plan should be about making the most of your life. We all know we are going to die one day, so why not aim to ensure that you have lived your life to its potential, and have done all the things you set out to do?

A strong financial base will give you the freedom to make choices for you and your family.

What happens to people without a plan?

We all have good intentions, so here are some genuine statistics which might prompt you to some action. We probably all know people who fit into these categories...

We are all living longer

In 1901 the average life expectancy at birth for a man was 45, in 2002 this was 76. For those who make it to 65, men can expect to live until 81, women to age 84. Source www.statistics.gov.uk

What this means is that the traditional retirement no longer applies. We are more active, and live for longer; therefore we need more money and probably want more flexibility with it.

The state can't afford to provide for you

People tend to believe, wrongly, that the state will provide for them. As the population ages, the ratio of working people to retired will only get worse, meaning there will be fewer people available to pay for retirement benefits.

The basic state pension is currently £102.15 per week for a single person. The current plans mean that most people won't get this money until age 65 at the earliest, and some people will have to wait until they are aged 68.

The question is whether you would like to live on this amount when you get to retirement. What would you have to give up?

With an aging population, it is no surprise that the Government is forced to cut benefits and extend retirement ages.

Savings, what savings?

According to a study by the Yorkshire Building Society, the average person's savings would last only 52 days. Think about your own outgoings. How long would your lifestyle last if you lost your income? Would you have enough put by to cope with an emergency?

I won't get sick

Hopefully you won't, but you might. According to the Department for Work and Pensions in 2007, you had a 1 in 13 chance of claiming on life assurance; a 1 in 8 chance of claiming for critical illness, and a 1 in 5 chance of claiming on an income protection plan. Yet, according to Mori in 2008, the same amount of people insured their teeth as their incomes! That's 6% if you're interested!

If you get sick the Government will give you £99.85 per week (Employment Support Allowance in the "Support Group"). If you do not pass the rigorous tests to get this benefit you are deemed to be able to look for work and therefore go on the lower rate for the Work Related Activity Group. During the assessment phase you can claim up to £67.50 per week.

How many days just to pay your tax bill?

The Adam Smith Institute calculates that you need to work until May 30th to pay your tax. That means your money is not yours until you pass this point. Yet people talk about their income before tax. If you think of the expense of your tax bills, this puts your disposable income into perspective.

A debt mountain

The average household debt in the UK (excluding mortgages) is £9,180; if you take out those who have no personal loans this rises to £21,355. If you include mortgages this is £58,290. See creditaction.org.uk

Many people use debt to fund their existing lifestyle, which only serves to feather the nests of those lending money.

As well as this, there is a worrying trend to use interest only mortgages. These products help people to save money in monthly payments and provide flexibility, but many people do nothing to work towards paying off the capital of their loans. This could lead to severe consequences later in life.

How much money do I need to retire?

Obviously this depends on your expectations in retirement. As a rule of thumb, you should be able to achieve an income of around 5-6% a year from your cash assets (pensions, ISAs etc). Thus, if you have £100,000 this would equate to roughly £5,000 to £6,000 per year. Of course, this all depends on the age you are, how much risk you want to take and so on.

4. A step by step guide to being a smarty-pants - The 10 key areas of your financial plan

Here are the main areas which need to be covered. There may be other areas, depending on your own circumstances. You need to think of your plan as a whole because your financial decisions are inter-linked. For example, if you have an expensive mortgage this may impact on your ability to save for the future. You will need to get together data on every aspect of your financial situation.

Setting goals

Without an end in mind, it will be difficult to evaluate your progress. Therefore you should think carefully about what you want your future to look like. These goals should be measurable.

Assumptions and attitudes

You need to take account of the changing world, and factor this into your planning. For example, you should estimate the increase in the cost of living, and how this will impact on your planning. You also need to think about how your income may change as your circumstances change, and how many other variables make an impact on your future. This is a complicated area, so many people ignore it, but doing so will definitely hit your wallet. Just think – how much cheaper was a pint of milk 10 or 20 years ago, and how much more will it be in another 10 or 20 years? If you don’t factor this into your planning, you may only have enough to pay for your lifestyle.

Income and outgoings

This is fundamental to building your plan. If you spend less than you earn, you have a chance to affect your financial future. If you spend more than you earn you will have limited options and could spiral into debt. Understanding tax is a big part of this.

Assets and liabilities

You need to build up assets to underpin your financial future. And more importantly you need to build up the right kinds of assets. The sooner you can be debt free (unless it is the ‘right debt’), the sooner you can be in control. For planning purposes we ignore certain types of assets.

Emergency funding

Making sure you can cope with short-term crises is vital. We recommend that you set aside 3-6 months worth of outgoings. For some people we recommend more savings in this bracket. If your income is based on self-employment, you might want to consider putting aside 12 months of expenses.

Protecting what you’ve got

You should think about what happens if things go wrong. This includes all types of insurance to ensure your lifestyle is defended from catastrophes. You should also consider making wills and powers of attorney etc.

Paying off debt
Generally, any debt is a barrier to your future prosperity. The sooner you become debt free, the sooner you have control over your future. Remember that your bank manager includes your mortgage as one of his assets!

Saving for the future and investing wisely
You need to work out how much will be needed to fund your future goals, how much risk this requires, and the effect of external forces such as inflation, charges and future legislation.

Tax
While this should not drive your plan, it is certainly an important part of the equation. Understanding how tax affects your life should run throughout your plan.

Monitoring your progress
Financial planning should be much like servicing your car. You wouldn't spend £20,000 on a new car and then never take it to the garage for a service. Likewise, you should regularly review your plan to ensure your remain on target to meet your goals.

Of course, your circumstances will also change over time, so your ultimate goals may also need a tweak from time to time.

Conclusion
As you can see, a proper financial plan should be extremely detailed, and will take some work. However, the rewards will really benefit you as you will be back in control of your life.

5. How to avoid burying your head in the sand - Why you should set financial goals?

Simply put, if you don't set goals then you can't measure success
Many people try to live their lives without setting goals, and then fall short of their expectations because they were not trying to strive for something specific.

The reason that most people put off setting goals is probably why you should in the first place. Most would say they are too busy, but by spending the time to think clearly about what you want from life you can start to focus on what is important to you.

This does not need to be financial. Think of your financial plan as a route to enable you to achieve all that you could want from life. This will help you to get things into perspective, and focus on what you really want from life.

You might want to think about other areas of your life such as work, family, personal achievements, your health, education or community. Your financial plan is relevant to all these areas because a strong financial base will give you more room to achieve your other goals.

How to start

Most people start with the 'stuff'. They list possessions that they want like houses, cars etc. When you delve a bit deeper you can then uncover the real motivations behind your spending decisions to date.

Try to answer these questions

Try the excellent analysis provided by Richard Kinder in The 7 stages of money maturity. His philosophy is heavily influenced by Buddhism, but this means that he focuses less on the money itself, and more on what this can achieve for your life.

- If you had all the money you needed for the rest of your life, what would you do differently?
- If your doctor told you that you had only 5 years to live, what goals would you have for the rest of your life?
- If you found out you only had 24 hours to live, what would you wish you had done?

If you can answer these questions you can then start to focus on what you really want. This will help you to develop financial goals which enable you to achieve your vision.

Make your goals SMART

Your goals should follow these well-known rules, to ensure that you have some chance of making them happen:

S - Specific - if your goals are vague they are unlikely to happen

M - Measurable - your goals must have some form of measurement such as a monetary amount.

A - Achievable - you don't want a wish list, rather something possible.

R - Realistic - don't aim for the stars unless this is grounded in reality

T - Timed - this is very important as it will give you an idea if you are on track.

So, an example of a SMART goal might be...

- To retire at age 60 with a net income of £25,000 in today's terms.

Once you have your goals in place you can start to build your financial plan. And of course, your goals will change as your life develops, so you must review your goals periodically.

Set your priorities

Once you have set your goals you should think about your priorities. You might not attain all your goals, so you should set the order for which you will attain first. This way, you can focus your resources.

Next steps

To start you off on goal setting, why not try our goal setting template?

6. A bit of fortune telling - why are assumptions important?

We all know that life moves on, and prices never stay the same. You therefore need to take account of changes to things like inflation because otherwise your plan will not be accurate. I can almost hear you yawning from here, but this is genuinely one of the most important aspects of planning for your future prosperity. It is also one of the most difficult to get right, which is probably why most people don't even start. If you can make a realistic stab at some of these issues, you will be stealing a march on most people you know.

Be cautious

It is better to be cautious and underestimate things (thus having more than is needed in the future). The alternative would be to overestimate effects, which could leave you with less than planned, or having to take more risk.

You should also think about how things have changed in the past over the long-term, rather than what is happening at the moment, as this might be outside the general norm.

Assumptions to consider

Inflation
Think about the price of goods 10 years ago. How far would £100 have gone then, compared to now? Generally, prices increase over time, so you should factor this into your calculations. This is important because £100 saved now won't be as valuable in 20 years time. Also, if you want to provide an income for the future in today's terms, you need to work out what £20,000 now will be in 20 years time. See the Retail Prices Index.

Earnings
You may base your future ability to plan on your earning capacity. If you overestimate this you might not get back as much as you thought. See the National Earnings Index.

Expenses
Your earnings will probably rise, but so will your expenses. Don't forget to factor this into your plan. Of course, some expenses will have a finite period - for example your mortgage will hopefully be paid off in the future.

Investment returns
Assets all perform differently. You therefore need to assume that they will grow at different rates. For example, you can expect cash to grow differently to shares, and differently to property. You also need to think about the growth of the underlying assets (the capital), and the income returns. For example, bank accounts have zero capital growth, and low income returns.

Charges & interest rates
Don't forget to include product charges into your calculations as these will reduce

the value of your savings over time. You should also consider future changes to interest rates on your borrowings.

Attitudes to consider

Your general attitudes towards your goals will affect how you approach solutions to your goals. We concern ourselves with monitoring future risks to your financial well being. Here are some important factors to consider:

Investment risk

Generally, risk is linked to reward over time. On average, over time, the greater risk you take with your money, the greater return you should hope to make. But this comes at a cost of short-term fluctuations, which can mean you risk losing capital.

You should think about how much risk you are prepared to take with specific aspects of your finances. For example, you should probably take no risk with your emergency funds, whereas you might be prepared to take more risk with longer term savings like pensions, which you could make up at a later date. You might also take a different level of risk on a specific project.

Mortality and morbidity risk

This measures the risk to you or your family of financial loss due to death or ill health. We can measure the likelihood of these events happening using statistical evidence. You should also consider your attitudes towards these risks. Are you concerned about the risk to your family's lifestyle should you or your partner die or be unable to work due to illness? Think about the likely effects of these events, and the impact on your lifestyle. If you have assets to enable you to weather the storm you may not be concerned. However, if not, you may wish to consider insurance to cover these issues.

Next steps

Work out your estimates for future financial change in important indicators such as inflation and earnings. This will have an important bearing on your future plans.

Think about the risks you are prepared to take with your savings and investments. This should be your first step in understanding your attitudes towards investment risks.

You may also wish to consider the financial loss to your family if you or your partner dies or gets too ill to work. This may affect your future ability to achieve your financial goals.

7. Not keeping up with the Joneses - pending less than you earn is the slow way to get rich

Understanding the relationship between your income and expenditure is vital to your future prosperity. If you can consistently spend less than you earn you can work out a plan to best use any excess income towards your future lifestyle. Ultimately, this is about analysing your income and expenditure, not necessarily making a budget. Although, having a budget is probably a good place to start for most people, as it will be some sort of framework to work towards.

Project into the future

You should also think carefully about how your income and expenditure may change over time. For example, you may hope for pay rises each year; your expenditure will also change as prices go up, and your circumstances change.

Most people expect to retire one day. You need to plan for how your income and expenditure will change at that point of your life. Your income may be different: perhaps less from earned sources, and more from investments and pensions. Your expenditure may be different: perhaps more on leisure and hopefully less on things like mortgages!

Income - gross and net

Most people, when asked will tell you what they earn in gross terms: 'I earn £50,000 per year'. This is true, but does not tell the whole story. You need to understand the link between gross and net earnings. As far as we are concerned, tax is simply another cost you have to bear. For example, the typical personal in a job on the salary mentioned will pay Income Tax & National Insurance. Add to this other taxes such as VAT and Council Tax.

The net amount received after tax for someone earning £50,000 pa might be around £36,000 (depending on the prevailing tax situation). This is a cost to you of £14,000 per year (or 28% of your gross earnings). So, to buy that £1,000 TV you actually need to earn £1,388.

We're not saying that tax is a bad thing. After all we all need roads and hospitals. However, thinking about how it affects our income certainly focuses the mind on our spending habits.

Debt

Most people spend a large portion of their income on debt payments. While this may be necessary, it is not desirable in the long-term. If your debt payments are 25% of your gross income, you will be spending over half of your money (including your tax) before you even get a chance to buy essentials like food.

Expenditure analysis

If you take the time to work out what you actually spend your money on, it can be a sobering experience. It is very easy to waste money on small purchases, but these soon mount up. For example, if you spend £5 a day on your lunch, for 48 weeks of the year, this will cost you £1,200 per year.

If you break down your expenditure you can soon start to work out what is necessary and what is not. Then you can prioritise.

Be realistic!

We often see clients who are not honest with themselves when it comes to their spending. If, when you analyse your income versus your spending, you find you have a larger surplus than expected, you are probably underestimating some of your spending habits.

Aim to live within your means

It sounds simple, but many if not most of us fail to live by this simple mantra. But most people who have succeeded in becoming millionaires have lived by this all their life. If you can spend less than you earn you can use the excess towards your financial goals. The reverse, spending more than you earn can only lead to debt and disaster.

So when you have analysed your spending, you should be able to see a clear picture of what resources you currently have to put towards achieving your goals.

Conclusion

Many people find that undertaking this exercise is actually quite motivating. As you gain some control over their budget, you can start to feel some control over the rest of your life. You may then find that you work harder on other areas of your financial life - perhaps to spend less, perhaps to earn more.

Next steps

You need to start with an analysis of your income situation. List all your income sources, and then work out the difference between your pre and post tax income. You should find this information in documents like your payslips.

You can then analyse your income. We have produced a handy form for this purpose, which should help you to be systematic in your approach, and not forget anything.

Take your time to do this. It will be hard work, but worth it.

8. You're probably not worth as much as you thought

This section is about assets and liabilities. Put simply, your assets can help you to achieve your future financial goals, and your liabilities will hold you back. Assets can help you grow your income, and liabilities will grow your expenditure. Not only that, but your liabilities could also hold back your ability to grow your future assets, and thereby affect your future income!

What are your assets?

You should be able to list all your assets. This would include the following, but could be anything of value:

- Property
- Pensions
- Investments
- Bank accounts
- Businesses

Therefore, it should be relatively easy for you to estimate how much each of these categories are worth.

Good assets and bad assets

This is where a lot of people fall down in their planning. You need to think about how your assets affect the rest of your financial life.

Your house

When we ask most people what is their biggest asset, what do you think is their response? You would probably say your house. Well, as far as we are concerned, your house is your biggest liability.

OK, we realise that a house is an asset in the traditional sense, but it is also a huge drain on your resources. Think about it for a minute. If you have a mortgage, where do you think your bank puts your mortgage/house? That's right, in their assets. That makes it a liability for you. Also, if you want to cash in that asset, where will you live? Well, you will need to buy another house, so it doesn't really count for financial planning purposes. Of course, if you downsize you could release some equity, but how many people actually choose to do this? Along with a house comes a lot of expenditure - council tax, mortgage, utilities, maintenance etc.

Your pensions

Another big asset for many people are their pension funds. The trouble with pensions is that the Government tells you what you can and cannot do with them. You cannot take benefits until at least age 55, and only 25% can be taken back from the fund; the rest buys and income. For some people this inflexibility means that pensions are not as desirable as other asset types. Of course, pensions do have a place in your plan, with excellent benefits such as tax relief.

Your business

Your business may have a value (although how much does depend on what someone else may be prepared to pay for it). However, it can be dangerous to assume that your business will grow at a uniform rate until you come to sell. Your business may be worth a lot less than you think. We prefer to think of businesses as cash generation tools for income, which can go towards creating more of the correct asset types below.

Readily realisable, income producing assets
These assets are the holy grail of financial planning. You need to work on building up assets which could be cashed in at any point and spent on your lifestyle. This gives them flexibility to be used when you might need them, and also diversifies away from less flexible assets as outlined above.

If you then combine these assets with income generating capability, this will only serve to increase your future income, thus growing your future assets. This is the power of compound interest in action, working for your benefit. Good examples of such assets might be:

- Rented investment property
- Shares/ISAs/other investments
- Bank accounts

What are your liabilities?

In modern times is virtually unheard of to be completely debt free, and indeed this can come with some problems. The trouble is that this affects your ability to grow enough assets (of the right type) to be able to fund your future lifestyle without having to work.

Typical liabilities include mortgages, credit cards and loans.

What to do about (bad) liabilities

Our suggestion is that you should always aim to pay off debts as quickly as possible. This will serve you well in the long term as the interest saved can be put towards your lifestyle now in the form of expenditure, or to building assets for your financial future. Generally speaking, debt costs more than the gains from savings or investments.

Remember that your liabilities are someone else's assets. The sooner you pay off your debts the better off you will be.

Good liabilities

In certain cases, it can be good to have debts. If someone else is paying that debt (such as with a rental property) then this can be a good long term strategy towards capital growth. However, this does come with risks so be careful to understand them.

Next steps

You should put together a list of all your assets, plus all your liabilities. Then you can break these down into good and bad types, focusing on reducing debts, and increasing readily realisable income producing assets.

9. What if the roof caves in – an emergency fund

Everyone should have an emergency fund. This is a pot of money that you put aside in an instant access account and leave just in case you need money quickly. This is not to be used to speculate, and it is not to be used to go on holiday with (you should build up separate pots for those issues if you want).

The point of an emergency fund is that you should have enough money to be able to see you through if a minor disaster strikes, without needing to affect other parts of your longer term planning, or worse, resorting to debt.

As a general rule of thumb you should put aside 3-6 months worth of expenditure. If you are self-employed, you might want to think about extending this to perhaps a year’s worth of expenses, just in case you have a difficult trading period.

What if you don’t have an emergency fund?

Well, you run the risk of dipping into other assets. This could mean that you impact on your ability to plan for the longer-term. You could also attract other penalties such as charges, or it just might not be the right time to cash in those investments. Some investments are not liquid. For example, if you had all your money tied up in property there would be an inevitable delay if you wanted to sell, and it might not be the right time to get the best price.

It works the other way too. If you have too much put aside, then this money is unlikely to be working best for you. In general terms, bank accounts tend to lose money after taking into account inflation. So, unless you are completely risk averse, or need access to your money, you should look to invest the excess over what is needed for use in emergencies.

Avoiding debt

Many people who don’t have savings put aside for the use in emergencies run the risk of using credit cards and loans to pull them through financial difficulties. Having savings means that you can avoid costly debt charges, which can be 15-25% per year. Debt makes your expenses higher, and holds back your future development.

Next steps

Work out how much you think you need to set aside. Then set up an account and transfer any excess income into it until you have enough set aside. Do not put any money towards other longer term goals until you have this in place, and don’t worry too much about the rate you are getting on this money. If something goes wrong one day, you will be glad of the money.

10. Protecting what you've got – insuring the golden goose

This part of your plan should examine the likely effects on your finances is some sort of disaster happens to the family. Usually, this means protecting the family against the effects of the death or serious illness of one of the breadwinners.

This needs to be balanced because family protection will be an expenditure (which could otherwise go towards your goals), but ultimately your plan should aim to provide a safety net should the worst happen.

The main risks

These will focus around:

Death of a breadwinner
If someone within the family dies, most people would want security for their family's home, so paying off debt should be a major priority. However, the future needs of the family should also be considered. For example, if one member of a couple dies how will the child care arrangements be addressed? Some families may need child care to be paid for, thus allowing the surviving partner to work. If so, an ongoing income may be required.

Illness of a breadwinner
This can be extremely debilitating. Imagine how you would cope if one of the breadwinners became too ill to work for an extended period. How would this affect your income? Of course, with a reduced income, this could ultimately affect your ability to meet your goals.

Unemployment
Another risk is that a breadwinner is made redundant. Again, think about how your family would cope if an income stops.

Possible solutions

The following methods may be used to protect your family against the main disasters:

Emergency fund
The basic protection should be a fund to cover the main family expenses for 3-6 months, which should be available in an instant access account. This should tide you over through most short-term problems.

Life assurance
This is a form of insurance which pays out a lump sum in the event of the death of a breadwinner. Many people use this to cover their mortgage, but you can also use it to provide a fund for future family income.

Family income benefit
This is a form of life assurance which pays out an income in the event of the death

of a breadwinner. The income would be paid for a specific term, perhaps until the children are old enough to leave home.

Critical illness cover
This is a form of insurance which pays out a lump sum in the event of a serious named illness of a specified severity. This can be used to provide cover against debts, for income, or to provide a lump sum to make alterations to the home in the event of disability.

Income protection
This is a contract which pays out an income after an initial period for as long as the insured is too sick to return to their former work. Thus, an income can be replaced while you are too ill to work, but will cease when you are well enough to return.

Unemployment cover
Employed people can cover their major expenses for a limited period (say 12 months), if they are made redundant by their employer.

Private medical insurance
You can provide cover for non-emergency operations through private healthcare. This can mean that you are seen more quickly than on the NHS, which could mean a quicker recovery; this might be particularly useful for the self-employed.

Other areas to consider

Wills
Everyone should have a will as this ensures that you will know how your assets are distributed on your death. Most people do not have a will, and many are not regularly updated to take account of changing circumstances. The only way to be sure of providing for your family is to make a will with a qualified professional.

Lasting powers of attorney
This is a legal document which allows a trusted person to take control of your finances if you are incapacitated for some reason. This could mean mental illness, but could also be something like a serious car accident, which puts you in a coma. If you do not have this document in place it will take months for the Court of Protection to intervene, which can lead to real hardship.

Business agreements
If you own a business you should think about making plans for succession and how your assets are treated in the event of serious illness or death.

Next steps

Find out what levels of cover you may already have in place. This may be personal insurance policies, cover through work like death in service, or sick pay arrangements, plus lump sums from pensions etc.

You should then aim to plug the gaps in the areas mentioned above, which are particularly important to you.

11. Becoming debt free – real financial maturity

Your debts are someone else's assets

Debt may be a necessity for most of us, mainly to buy a home, but the interest repayments are hampering your ability to save towards your financial goals. The sooner you can be debt-free, the sooner you can work towards your financial independence.

The company that loaned you money wants a steady income from your debt, so it is often not in their interests to help you to repay the debt sooner. Nevertheless, you can usually may extra payments towards debts, which will help you to pay the capital owed off sooner.

Compound interest

If you save £100 and get interest of 10% on this, after 1 year you will have £110. If in year 2 you get another 10% interest, you will have £121. Thus, your interest will be earning interest. This is compound interest in action. With debts this is working in someone else's favour, not yours, so you need to reduce the power of the compound interest as quickly as you can afford to.

Some debts are more expensive than others

It goes without saying that this is true. In general, the less risky you are as a borrower, the cheaper the debt will be, and if the debt is secured against an asset, then this makes it even safer, and therefore cheaper. The downside is that you lose control over your asset. To give you an example, you do not own a mortgaged house - your mortgage company does. It only becomes fully your asset once the loan is repaid.

In general, mortgages are fairly cheap in percentage terms, personal loans are more expensive, and credit cards are even more expensive. However, you need to take into account the term of the loan, as you can end up paying more in the long run with a cheaper long-term loan than an expensive short-term loan. This is the power of compound interest.

Making minimum repayments

It is common, especially with credit cards, for a provider to insist that you make minimum debt repayments. It can seem attractive to simply make these repayments because they keep your outgoings low. However, in the long run this will make you pay more interest.

For example, it is typical for a credit card to require repayments of 2% to 3% of the balance per month. This payment would result in only a small proportion of the debt being repaid, the majority being interest. This can mean that you would take many years to clear the debt. When you consider the very high interest rates on credit cards, this can mean thousands of pounds in extra interest.

The effect of overpaying

If you can overpay on your debt, even by a small amount each month, this can reverse the effect of compound interest. The overpayment (if allowed by your contract), will reduce the balance quicker, leading to less interest being paid.

You should always bear in mind that your debts may have penalties to redeem the balance. We advise that you examine your contract carefully!

Also, different contracts will calculate interest in different ways, so you need to be careful in your calculations. Each loan will give a comparative indicator, called the APR (annual percentage rate). This will give a percentage annual rate based on the total charges for the scheme.

Which debt to repay first?

The general advice is to combine all your available resources into the repayment of one debt at a time, to repay this as quickly as possible. Normally, we would recommend that you repay the debt with the greatest interest first.

<u>Some examples</u>
In these examples we have assumed that interest is applied monthly and there is no penalty for making regular overpayments.

Credit card balance:	£5,000
Interest rate:	25%
Minimum repayment:	2.5%
Monthly repayment:	£125.00
Total interest:	£5,862.28
Total repaid:	£10,862.28
Paid off in:	7 years and 3 months

<u>Example 1</u>
Extra monthly repayment: £25.00

Interest saved: £2,236.78

Paid off: 2 years 5 months early

<u>Example 2</u>

Extra monthly repayment: £125.00

Interest saved: £4,326.86

Paid off: 5 years early

Equivalent tax-free growth

If you were to calculate the amount your overpayments would have to grow by each year to generate the interest saved, this equates to a tax-free growth figure. In the case of example 2, this equates to a growth of 57%. There are few 'investments' that could promise this level of 'growth'.

Next steps
List the debts you have outstanding, including the amount and rate. Then work out how much you can afford to overpay each month, however small. Apply this to the most expensive debt by rate until it is completely repaid. Then take the total amount of the repayment, plus the overpayment and overpay this amount on the next more expensive debt. This will be the quickest way to become debt free.

12. Avoiding the main pitfalls in investing

How much do you need to accumulate?
We are now focused on building up assets to use in your future. This very much depends on the lifestyle you need to support. You should have a good idea based on the goals you have made, and the assumptions you have taken into account for the future. Ultimately, this will guide you to how much you need to save, and over what period.

Understanding capital and income
To us, the best kinds of assets are those which enable you to accumulate capital and income (unless there is a good reason otherwise). Thus, shares are a good example of this since they will hopefully grow in value, plus produce an income in the form of a dividend.

Risk v return
In general terms, the more risk you are prepared to take the greater returns over time you will hopefully generate. Of course, nothing is guaranteed with investments. Therefore, if you are risk averse you should aim for steady returns with lower risk of capital loss, and if you are happy to see your capital fluctuate you should aim for greater returns.

Assessing and monitoring risk
This is a very important aspect of planning your investments since you should not take risks which you are not happy with. Our clients all go through a rigorous profiling exercise to determine the level of risks they are prepared to accept. This is the starting point of your assessment, since you then need to understand the implications of your risk appetite as well as possible returns. You should reassess your risk appetite as your circumstances change.

Diversify
Different assets perform better at various points of the economic cycle. Therefore try to spread your risk by investing in different types of assets so that hopefully you can smooth out any fluctuations. The idea is to try and secure a steady growth over time rather than suffer from wild volatility.

Rebalancing
Make sure that one asset type does not overtake others as they grow at different levels. Therefore, try to rebalance your mix of assets back to your ideal at regular intervals.

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Inflation, charges, costs, returns, tax

All these factors will have a bearing on the growth of your assets. Inflation will eat into your returns as prices rise. Investments will have charges; other assets will have costs associated with them. You need to think about the likely level of return you expect. Bear in mind that your assets will attract tax on the growth and income.

All these factors need to be taken into consideration in your plan.

Reviewing your progress

This is vitally important since you need to ensure that you remain on track towards your goals. There will be periods when assets perform poorly, and this needs to be assessed against your overall plan. Don't expect plain sailing all the way because things are never that easy!

Ideas for savings

Obviously, there are many different types of assets and products which you may consider to help you to grow your funds. Our advice is to invest in what you understand, since no one asset type is better than another; it all depends on your personal situation. Here are some ideas for you to consider:

<u>Pensions</u>
Pensions are a great way to grow your long-term savings since assets grow largely tax-free, and you also get a fantastic boost from tax relief. The downside is that there are strict rules as to when you can access the money (from age 55), and only 25% can be returned as cash, with the remainder as income.

<u>Collective investments (including ISAs)</u>
These are not as tax-efficient as pensions, but have fantastic flexibility. You can invest in an amazing variety of investment funds of different types ranging from the relatively safe such as cash, up to specialist funds. The main benefit to you is that you can access your money at any point.

<u>Bank accounts</u>
Bank deposits make sense for money which may be needed in the short-term, since returns will be low, but security high.

<u>Property</u>
Many people consider investing in property. This is fine as a long-term growth asset, with the chance of a decent income as well. Be sure to understand the risks and costs of your investments. Remember, that your family home is not an asset in financial planning terms.

Of course, there are many other ideas for investment. Make sure you do your homework or seek professional advice before you put your money to any scheme.

Next steps

Work out how much you need to save, and assess your risk profile.

13. Everything changes - when to review your plan

This depends on your circumstances, but should be at least annually, and probably when something major happens to your personal or financial situation.

Think of your personal circumstances over the last 5 or 10 years. I bet they have changed dramatically over that period. Your income will be different, as will be your expenses. You will probably have different interests, and your family situation will have changed. Perhaps more fundamental changes will have occurred, such as a changing attitude to risk as you understand more about investing and financial planning, or perhaps become more risk averse as your retirement gets closer.

The point is that as you change, so should your financial plan.

What to consider in your review

Guess what? You will need to go through the whole of the process again! Think about how all of these aspects have changed:

<u>Goals</u>
Your goals may have altered or you may have new priorities as you achieve previous goals.

<u>Assumptions</u>
You may find that your previous assumptions were not realistic, or were too pessimistic. This is vital to get as correct as possible since assumptions either way can have a dramatic bearing on the results of your plan. All the assumptions you make will be wrong because none of them will be static or definitely predictable.

<u>Income</u>
This will change (hopefully upwards) as you become more valuable in your job, and as your assets grow.

<u>Expenditure</u>
No doubt, this will change as your personal situation alters.

<u>Assets</u>
You will need to update your schedule of assets since values will fluctuate.

<u>Liabilities</u>
Hopefully, you will make progress to reducing these, but again you need to keep on top of the changes.

<u>Emergency funds</u>
You may have had enough to fund an emergency at the last review, but should ensure that this is updated to reflect your current situation.

<u>Protection</u>
Reassess your requirements based on your attitudes, assets and family commitments.

Paying off debt
Your plan should be showing fruits if appropriate, but you should work hard at this area, and divert further resources towards it if possible.

Saving for the future
Reassess your plan for growth of your assets, including how your attitude to risks has changed. Rebalance your assets if some have grown quicker than others. Investigate the performance of your assets to determine whether they are meeting expectations.

14. What next?

We want you to get the most out of this guide, but remember the tips given here are general by their nature. After all, we know nothing about you!

We believe that the information given in this guide should be a good starting point for your journey towards financial independence. If you take some time to work through the sections you will be doing some good work on your financial future. However, this is hard work. You know where to come if you want some help…

We work with people like you who have made this important first step, but want us to take the hassle away from them. If you have a real desire to find out the truth about your money, get in touch.

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