

The Financial Planning Guide 101

Three Step Process to Protecting and Growing Your Wealth

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A Note From The Author

This e-book is based on the insights from a professional financial advisor with years of experience in working with many clients across the United States with global reach. Its intent is to educate you on the basics of financial planning. For questions about your specific situation, please reach out to the author to have a more in-depth discussion.

Introduction

Many people realize that financial planning is important, yet don't know *why* or *how* it's important and don't have a complete plan that incorporates all the major components. If you're one of these people, you're probably asking yourself, "what are the major components of a financial plan?" To answer this question, you must understand that financial plans are constantly changing and require daily attention to ensure that all the parts of the plan are functioning properly together. There are many things that are beyond your control, such as the stock and bond markets, foreign politics, and unexpected life altering circumstances, to name a few.

The purpose of financial planning is to control what you can. You can plan for different scenarios and be ready for whatever uncertainty life throws your way. Now that you know the why, let's talk about the how and actually answer your question. The three critical components of a financial plan are: investment planning, tax & estate planning, and general financial planning.

Chapter 1 – Investment Planning

Taxable vs. Non-taxable Assets

Before you create an investment strategy you must first consider whether the assets you are investing are taxable or non-taxable. It's important to understand this distinction because the consequences of not knowing can be costly. Taxable assets are subject to potential taxes if you are realizing gains through buying and selling.

Examples of taxable assets are individual and joint brokerage accounts and many types of trust accounts. Tax harvesting is important when you are dealing with taxable investment accounts and should be done each year. Non-taxable assets, also called retirement accounts, can be tax-deferred or tax-free. Examples of types of retirement accounts are 401(k)'s, 403(b)'s, IRA's, and Roth accounts.

Portfolio Construction

When creating an investment portfolio there are lots of things to think about and incorporate. Some of the high-level considerations are diversification, performance, your age and time horizon, and the cost to invest. There are professionals who do this for a living and spend their entire careers trying to build the optimal investment portfolio. These people are called portfolio managers or financial advisors. When a financial advisor is building an investment portfolio they should delve into the weeds and look at fundamental and technical analysis, research reports, financial statements, alpha, beta, and other financial metrics that the average person may not be familiar with.

They may also create investment policy guidelines that align with your investment objectives. If you are reading this you may want to think about talking to a financial advisor to help you manage your investment portfolio. Or, perhaps you already have a financial advisor and are looking to make a change. Regardless, you should be educated on the basics and this intends to do just that.

Diversification

What is Diversification? Diversification, as it relates to investing, is a strategy that one employs which aims to reduce the overall risk within an investment portfolio. Some people use the phrase "don't put all your eggs in one basket." The same theory applies to the average investor: don't put all your money into one company. The reason is because as diversification decreases, the probability of losing your money increases.

Imagine going to a casino and putting all your money on number 23. You could hit and win big, but the odds are against you and it's more likely that you'll lose it all. If, however, you spread your chips around the table

covering more numbers, the chances of you winning increase. When constructing a portfolio, it's important to consider diversification across different companies, asset classes, industries, sectors, and geographic regions.

Performance

Oftentimes, people may look at the past performance of a stock, bond, or fund and decide to invest in it because of how it did in the past. Keep in mind, past performance is not necessarily an indication of future results. Start by thinking about what your goals are. What do you want from your investment portfolio? Are you looking for growth, income, preservation, or something else? Once you figure out what you want, and you determine an appropriate expected return for your portfolio, forget about the noise. Meaning, if you are trying to preserve your investments and generate 5% per year in income from your portfolio, don't then compare yourself to the S&P 500. Avoid comparing an asset from one class to a benchmark in another. This is a common mistake.

Cost To Invest

You've probably read about the importance of compounded savings. The more money you have in your portfolio the more money you will make from compounding. The old adage "it takes money to make money" rings true. Cost is an important factor to consider when creating an investment portfolio. However, many people make the common mistake of letting cost alone drive the investment decision. This typically leads to poor investment selection because many good opportunities are screened out due to cost. Ensure that the costs are reasonable, but don't get too hung up on creating the lowest cost portfolio.

Age and Time Horizon

You should always consider your age and time horizon when constructing an investment portfolio. Do you have short-term needs to buy a house or make another large purchase? If so, perhaps you should consider more conservative, liquid assets that are easily convertible to cash and not subject to large swings. If, however, you are investing for the long-term, you may have more flexibility on the types of investments you implement. Generally speaking, the younger you are the more aggressive your portfolio can be. As you get older, typically you want to become more conservative to protect against any significant losses as you head into retirement.

Alternative Investments

There are many different types of investments that are considered "alternative" including real estate, private equity, hedge funds, options, specialty funds, and long/short funds. Before investing in alternatives it's important to understand what you are getting yourself into. Here's a good rule of thumb to remember: if you don't understand it, don't invest in it.

Consolidation of Accounts

Many times when people have had multiple jobs or moved around a bit they end up having accounts all over the place. This usually involves volumes of unwanted documents being mailed or emailed to you each month

of statements, prospectuses, trade confirms, and the like. Sometimes the simple fix is to just consolidate those accounts. For example, if you have had three jobs in the past with three separate 401(k) plans at different custodians, you may want to consider rolling all three of those 401(k)'s into one Individual Retirement Account (IRA). This will mitigate the amount of “stuff” being sent to you and will allow you to keep better track of your investments.

Chapter 2 – Tax & Estate Planning

Trusts & Contingency Documents

In general, many estate plans will include these five essential legal documents: last will and testament, revocable living trust, living will, healthcare proxy, and power of attorney. These documents all have specific functions which are beyond the scope of this e-book. However, you should be familiar with these concepts and learn more about why they are used and how they are implemented.

Revocable Living Trust

A revocable living trust is a document that determines how your assets will be distributed after your death. Revocable trusts can be amended during your life and, generally speaking, allow you to maintain control of your assets. Hence, the term “revocable”. Each state in the United States has different laws relating to trusts so it's important to understand the laws of the state in which your trust is set up.

Last Will and Testament

A last will and testament is a written document that expresses how you intend your property to be distributed at the time of your death.

Living Will

A living will is a written statement detailing a person's wished regarding their medical treatment covering circumstances in which they may not be able to provide a decision.

Healthcare Proxy

A healthcare proxy is a document that appoints an agent (another person) to make healthcare decisions on your behalf in the event you cannot make them yourself.

Power of Attorney

A power of attorney is a document that authorizes another person to act on your behalf in private affairs, business, or other legal matters.

Keep in mind that these are the basics. It's important to consider all the factors that are specific to your situation when creating a plan, such as your family dynamics, business interests, and net worth.

Funding Your Plan

A mistake that many people make is not appropriately “funding” their estate plan. Once you go through the process of creating an estate plan it is essential that you take the steps to ensure that it’s funded. This means taking the titling instructions from the estate plan that you’ve created and going to your bank to re-title your assets from your individual name to the name of your trust. The same should be done for your brokerage accounts, certain beneficiary designations, real estate, and other assets.

If you do not properly fund your estate plan you have defeated the purpose of creating it in the first place. Not all attorneys and financial advisors are diligent about ensuring that this is done. So, it’s up to you either to make sure that it gets done right or to make sure that you hire the right advisors in the first place. Mistakes in this area can be extremely costly.

Tax Planning

Do you like paying taxes? Most people don’t. Part of tax planning is thinking about ways to keep your tax bill under control. It’s important to consider things like tax harvesting, tax advantaged vehicles, income bracket management, and general tax strategy. Whether you use TurboTax or work with an accountant, it’s important that your tax plan aligns with your overall financial plan.

Chapter 3 – General Financial Planning

Cash Flow & Budgeting

It’s not uncommon for people to go about budgeting in the wrong way. A common mistake is to take one’s income, then spend on expenditures, and only save what’s leftover. Here’s some advice: pay yourself first. Start with your income and save an appropriate amount of money before you spend any of it. General rule of thumb is to save at least 20% of your earnings. Then, only after you have put aside money into your savings should you spend what’s leftover. This is easier said than done and without proper guidance very difficult for most. It’s important to maximize your positive cash flow so that you can meet unexpected monetary needs and so that you can maintain your lifestyle up to and through retirement.

Retirement Planning

How much do I need to retire? Will my money last? Which accounts should I draw from first? These are some of the most frequent questions people have no matter what age they are. The answers, on the other hand, can range significantly depending on your life situation. All the factors discussed above should be incorporated into your retirement plan.

If you get to this stage without having taken any action on the prior steps, you’re behind the eight ball. But don’t worry, it’s not too late. Start now. Keep in mind, the implications of retirement extend far beyond finances. It can be a very emotional process. You want to make sure that you are not letting emotions affect the financial decisions that you are making.

Special Projects & Other

You should have an overall plan for everything that touches your financial life. If you are considering taking a new job or contract, have a plan. If you are interested in buying or selling your home, have a plan. If you need to purchase a car, boat, aircraft, fine art or wine, or anything else, have a plan. There are many things in life that you cannot control, so control the things in life that you can. You should keep a personal net worth statement, also called personal financial statement, updated on a quarterly basis. There are a few benefits to doing so. First, this will allow you to easily track all your assets on one page in front of you. Second, if you are intending to obtain a loan from a bank they will require you to submit a personal financial statement. Lastly, a personal financial statement will be useful for estate planning so that you can easily identify how assets are titled and which ones need to be updated. For a free personal financial statement template, send an email to litchfieldfinancialgroup@claroadvisors.com.

Conclusion

Now that you have learned about the three integral components of a financial plan, take a step back and think about your own situation. If you aren't familiar with some of the topics that were discussed above perhaps you should do some more research, or even more, think about hiring a professional. Don't gamble your assets away on chance. Keep in mind that the above concepts are basic in nature. Your situation may call for more in-depth planning to meet your specific needs. Remember, financial planning is an ongoing process that should be done daily, it's not a one-time event. Be ready for anything life throws your way with a solid foundational financial plan.

Bonus Chapter: 10 Things to Know Before Hiring a Financial Advisor

1. Is the financial advisor a *Fiduciary*?

This is a very important element to consider when choosing a financial advisor. There are two main types of advisors: brokers and fiduciaries.

Brokers like Goldman Sachs, Merrill Lynch, Morgan Stanley, UBS, Wells Fargo, & many other Wall Street and main street firms sell proprietary products that enrich themselves and the firm itself. You should picture these folks waving a red flag reading 'conflict of interest.' Many of these above-mentioned firms are public companies which means that their shareholders come first, not you.

Fiduciaries are independent organizations that put your interests first. Fiduciaries have an open architecture platform thus eliminating conflicts of interest and reducing fees.

2. Is the individual a *qualified, certified financial advisor*?

Second to your family & faith, your personal financial situation is probably one of the most important topics in your life. That's why it's critical to select a financial advisor who has been certified by way of one of the following credentials:

- Certified Public Accountant (CPA)
- Certified Financial Planner (CFP)
- Chartered Financial Analyst (CFA)

3. How *old* is the financial advisor?

The average age of a financial advisor is between 50 – 60 years old. Advisors this age are most likely thinking about their own retirement, not yours. Select an advisor who has enough experience to handle your situation and is youthful enough to continue working with you and your family for the next 30 years. The last thing you want to do is to build a relationship with a financial advisor today, only to have to hire another one in five years from now.

4. How does the financial advisor charge *fees*?

Many financial advisors, including brokers, charge commissions, hourly fees, and other hidden fees. You want to avoid these types of advisors who get paid from multiple sources. You also want to be cautious of insurance and annuity brokers who claim to be “financial advisors.” If they work for an insurance company, you can bet that everything these folks recommend always ends up requiring you to buy more insurance (expensive commissions).

Fiduciaries have one source of income. Their fee is a percentage of the assets that they manage. Thus, their fee is aligned with your interests in mind.

5. What about *fund costs*?

Many financial advisors will sell A-share funds, C-share funds, other load type funds, contingent deferred sales charge funds, and structured products. Stay away from these types of products as they are expensive and not always in your best interest.

Fiduciaries use the lowest cost institutional class share funds. This simply means that they’re saving you money and putting your interests first.

6. Will you work with a senior financial advisor or get “*passed off*”?

Many financial advisors are salespeople who tell you all the great things you want to hear. However, once you become a client you end up getting passed off to someone that you’ve never even spoken to. This is a classic bait and switch. Make sure the person that you’re first meeting with is the same point of contact that you’ll talk to every time.

7. Does the financial advisor provide *comprehensive services (one-stop shopping)*?

Many financial advisors provide just one service, money management. You want to make sure that you hire an advisor who provides far more than that including, tax & estate planning, asset protection, retirement readiness, cash flow analysis, real estate advisory, and general financial planning.

8. Is the financial advisor *responsive*?

If you are interviewing a financial advisor and he/she takes a day, or two, or three to respond to your calls and emails how do you think the relationship is going to go after you become a client? If you're guessing the same, you're probably right. In this day and age, you want information, documents and advice...and you want it FAST! If the advisor is not timely enough during the interview process, move on.

9. Does the financial advisor work around your schedule or theirs?

Many financial advisors will try to get you to move your schedule around to make it convenient for themselves. Don't move around your schedule to meet their needs, make them come to you when YOU have available time. If they won't come to your home or office when it's convenient for you, don't hire them.

10. Is the advisor trustworthy and legitimate?

Many financial advisors will go through great lengths to hide their past. Lucky for you there is a totally public and easily accessible way to check up on the financial advisor(s) that you are interviewing. You can see ALL financial advisors' past records, work history, customer complaints, disputes, lawsuits, etc. through two independent sources:

1. Financial Industry Regulatory Authority (FINRA) <https://brokercheck.finra.org/>
2. Securities Exchange Commission (SEC) <https://adviserinfo.sec.gov/IAPD/default.aspx>

If you cannot find the advisors name in one of these databases, STOP. DO NOT HIRE THEM because they are not properly registered. If you see a "disclosure" on a broker or advisors past record, STOP. DO NOT HIRE THEM.

About The Author

Paul Litchfield is a fiduciary Wealth Advisor and Financial Planner. A fiduciary is a person who holds a legal or ethical relationship of trust with one or more other parties. Typically, a fiduciary prudently takes care of money or other assets for another person. Paul puts clients' interests first and is passionate about helping his clients meet all their financial needs through comprehensive planning. Paul was named a 2020 Five Star Wealth Manager* and was also named to the 2020 Top 100 People in Finance Magazine*.

Paul teamed up with Claro Advisors in 2018 to provide his clients with a deep bench of resources. Prior to joining Claro, Paul managed successful investment practices as a Vice President at another RIA and Morgan Stanley. Before transitioning to investment management, he worked for a public accounting firm in Boston as a CPA. Paul serves on the Board of Directors of The Miss Massachusetts Organization, a subsidiary of the Miss America Organization. He is the founder of AdVenture International, a 501(c)(3) non-profit that he created after spending a summer teaching math and English in Africa.

Paul received a Bachelor's degree in accounting and finance from The University of Massachusetts at Lowell and graduated Summa Cum Laude as a Commonwealth Honors Scholar. He holds a Master of Business

Administration from The University of Massachusetts at Lowell with high honors. Paul also serves on the advisory board at the University of Massachusetts Lowell.

Paul enjoys spending time with his family and supports the following causes: our service men and women, education, and helping mentor future generations. Paul is also a private pilot and enjoys flying airplanes in his spare time.

*See award disclosures at the end of this guide.



Let's Have a Conversation

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*See award disclosures on the following page.

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*The Five Star Wealth Manager award, administered by Crescendo Business Services, LLC (dba Five Star Professional), is based on 10 objective criteria. Eligibility criteria – required: 1. Credentialed as a registered investment adviser or a registered investment adviser representative; 2. Actively licensed as a registered investment adviser or as a principal of a registered investment adviser firm for a minimum of 5 years; 3. Favorable regulatory and complaint history review (As defined by Five Star Professional, the wealth manager has not; A. Been subject to a regulatory action that resulted in a license being suspended or revoked, or payment of a fine; B. Had more than a total of three settled or pending complaints filed against them and/or a total of five settled, pending, dismissed or denied complaints with any regulatory authority or Five Star Professional's consumer complaint process. Unfavorable feedback may have been discovered through a check of complaints registered with a regulatory authority or complaints registered through Five Star Professional's consumer complaint process; feedback may not be representative of any one clients' experience; C. Individually contributed to a financial settlement of a customer complaint; D. Filed for personal bankruptcy within the past 11 years; E. Been terminated from a financial services firm within the past 11 years; F. Been convicted of a felony); 4. Fulfilled their firm review based on internal standards; 5. Accepting new clients. Evaluation criteria – considered: 6. One-year client retention rate; 7. Five-year client retention rate; 8. Non-institutional discretionary and/or non-discretionary client assets administered; 9. Number of client households served; 10. Education and professional designations. Wealth managers do not pay a fee to be considered or placed on the final list of Five Star Wealth Managers. Award does not evaluate quality of services provided to clients. Once awarded, wealth managers may purchase additional profile ad space or promotional products. The Five Star award is not indicative of the wealth manager's future performance. Wealth managers may or may not use discretion in their practice and therefore may not manage their clients' assets. The inclusion of a wealth manager on the Five Star Wealth Manager list should not be construed as an endorsement of the wealth manager by Five Star Professional or this publication. Working with a Five Star Wealth Manager or any wealth manager is no guarantee as to future investment success, nor is there any guarantee that the selected wealth managers will be awarded this accomplishment by Five Star Professional in the future. For more information on the Five Star award and the research/selection methodology, go to fivestarpromotional.com. 3,580 Boston wealth managers were considered for the award; 463 (13% of candidates) were named 2020 Five Star Wealth Managers. 2019: 3,619 considered, 566 winners; 2018: 2,819 considered, 532 winners; 2017: 2,467 considered, 623 winners; 2016: 2,530 considered, 632 winners; 2015: 3,542 considered, 801 winners; 2014: 1,707 considered, 655 winners; 2013: 2,362 considered, 713 winners; 2012: 2,591 considered, 454 winners.

*The Top 100 in Finance award is designated by the Top 100 Magazine. The Top 100 Magazine utilizes proprietary software, which employs an algorithm to search a variety of online resources for industry-specific terms and key words. These resources include social media, blog posts, peer reviews, and Google indices. Once the software has compiled a preliminary list of qualified candidates, the Top 100 Magazine performs a manual analysis to verify top results and make final selection. The selection criteria is based on who are financial advisors or wealth managers, which meets the following criteria: 1. Registered with the SEC as a registered investment adviser or a registered investment adviser representative; 2. Not more than 1 filed complaint and never been convicted of a felony. Once selected, the Top 100 Magazine sends approximately 140 invites for the magazine, where final selection is on a first come first serve basis. Those selected for the Top 100 Magazine may purchase additional profile ad space or promotional products, but do not make any initial or additional fees for the award. The Top 100 Magazine selection is not indicative of the wealth manager's future performance or an endorsement by the magazine. Working with a Top 100 Magazine advisor or wealth manager is no guarantee as to future investment success, nor is there any guarantee that the selected wealth managers will be awarded this accomplishment in the future.