

A Framework for Success is Vital for Wealth Managers

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Whether you plan and manage your wealth yourself or you use the services of a professional adviser depends very much on what type of person you are and whether you have the time and inclination to gather the necessary knowledge and, probably more importantly, the discipline to apply the key principles in the face of adversity

Nothing about managing wealth is really that difficult but experience suggests that it is often very difficult for one to be totally objective about one's personal financial situation and to make good decisions without at least some form of outside assistance. A wealth management service makes most sense for those individuals who are natural delegators and have more important things to spend their time on or those who are uncomfort-

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able making financial decisions on their own.

There are various stages to developing a wealth management strategy and in simplified form these are encapsulated in Table 2. The key to a successful wealth plan is setting personal financial goals and objec-

tives, in the context of one's money values. In addition, agreeing and articulating financial planning policies will assist with future decision making.

Know where you are going and why – values, goals and planning policies

Money values are overarching beliefs that one has about money which follow a progressive hierarchy. The values conversation, as it is known, starts with asking the question: 'What's important about money to you?' Usually the first response will be general and basic like 'Financial security', which is a perfectly reasonable response. However, if one keeps following this line of questioning with 'And what's important about financial security to you', it will allow the individual to discover more deep seated values. It is this process of self actualisation that really helps one to find real meaning and purpose for the future financial plan. Some people find this process a bit uncomfortable as it requires a level of reflection and contemplation about money that is rarely experienced.

While setting clear financial goals is essential to developing a plan that works, not all goals are of equal importance. You might, therefore, find it helpful to categorise your goals as 'Required'; 'Desired', and 'Aspirational' goals (see Table 1 below for examples). The 'Required' goals are the most important and must be met, come what may and will usually involve meeting core living costs throughout lifetime, which we refer to as financial independence, that is

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that time when paid work is optional as you have enough resources available to fund lifestyle.

The 'Desired' goals are important

Examples of clear goals	
Aspirational goals	To give £500,000 to our own charitable foundation by the time we are 80
Desired goals	To fund the grandchildren's education at a cost of £10,000 per annum per child (3) assumed to start in 2009, 2011 and 2014 for 17 years
Required goals	To be financially independent by age 60 supporting a lifestyle costing £200,000 per annum in today's money

Table 1: Setting Clear Goals

but not at the expense of funding financial independence. Such 'desired' goals could be helping your parents in their old age or preserving assets for your children. The 'Aspirational' goals are essentially those goals that you wish to achieve if everything else has been catered for and perhaps investment returns have been consistently above those assumed. Such 'Aspirational' goals might be giving money to good causes or making specific gifts to family members in lifetime or after death. The point is that if the investment strategy has produced returns which are below the original assumption, it is the aspirational goals which take the back seat, not your core lifestyle expenditure.

Financial planning policies are tools for making good decisions in the face of financial uncertainty. They transcend the current situation by expressing in general terms what one plans to do and how one is willing to do it in terms not limited to the current circumstances. Such policies are broad enough to encompass any

novel event that might arise, but specific enough so that we are never in doubt as to what actions are required. An example of a financial planning policy might be

- I will give 10 per cent of my gross income to charity.
- I will only do work that I love.
- I will maintain sufficient life insurance to cover my children's education costs.
- We will provide family with financial literacy support but will not give them money.

Once we have clarified values, goals and financial planning policies we can then get to work on the main financial analysis.

Family balance sheet and lifetime cashflow

Your family balance sheet provides an insight into your total net wealth and will include:

- those assets you use, such as houses, cars, boats;
- investible assets such as cash,

investments, gilts and other liquid funds

- Pension assets such as personal and occupational money purchase schemes

Analysis can determine what resources are available such that capital will not be exhausted before age 99

- Ideas investments such as a business, alternative investments like EIS, gold or wine

From this analysis we can determine what resources are available to meet the various goals such that the capital will not be exhausted before age 99, that is that you run out of life before you run out of money! The idea

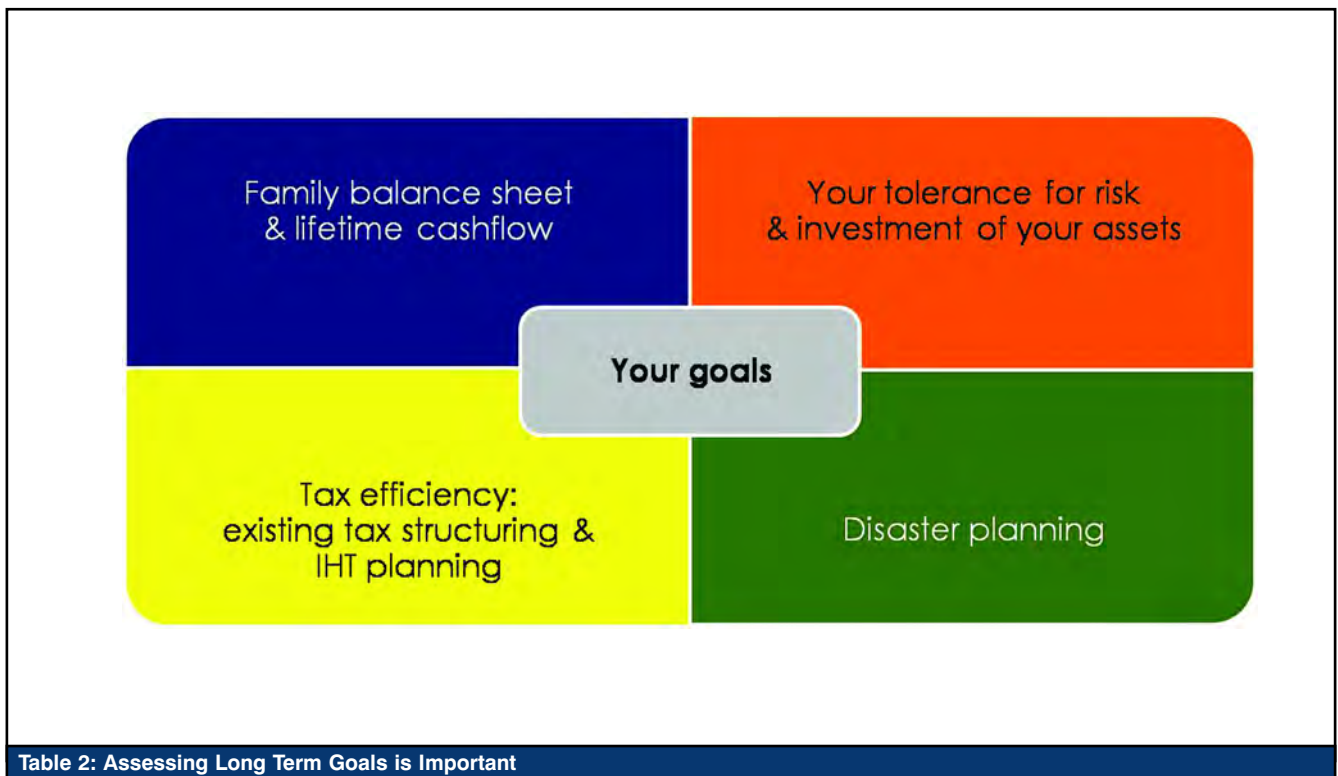
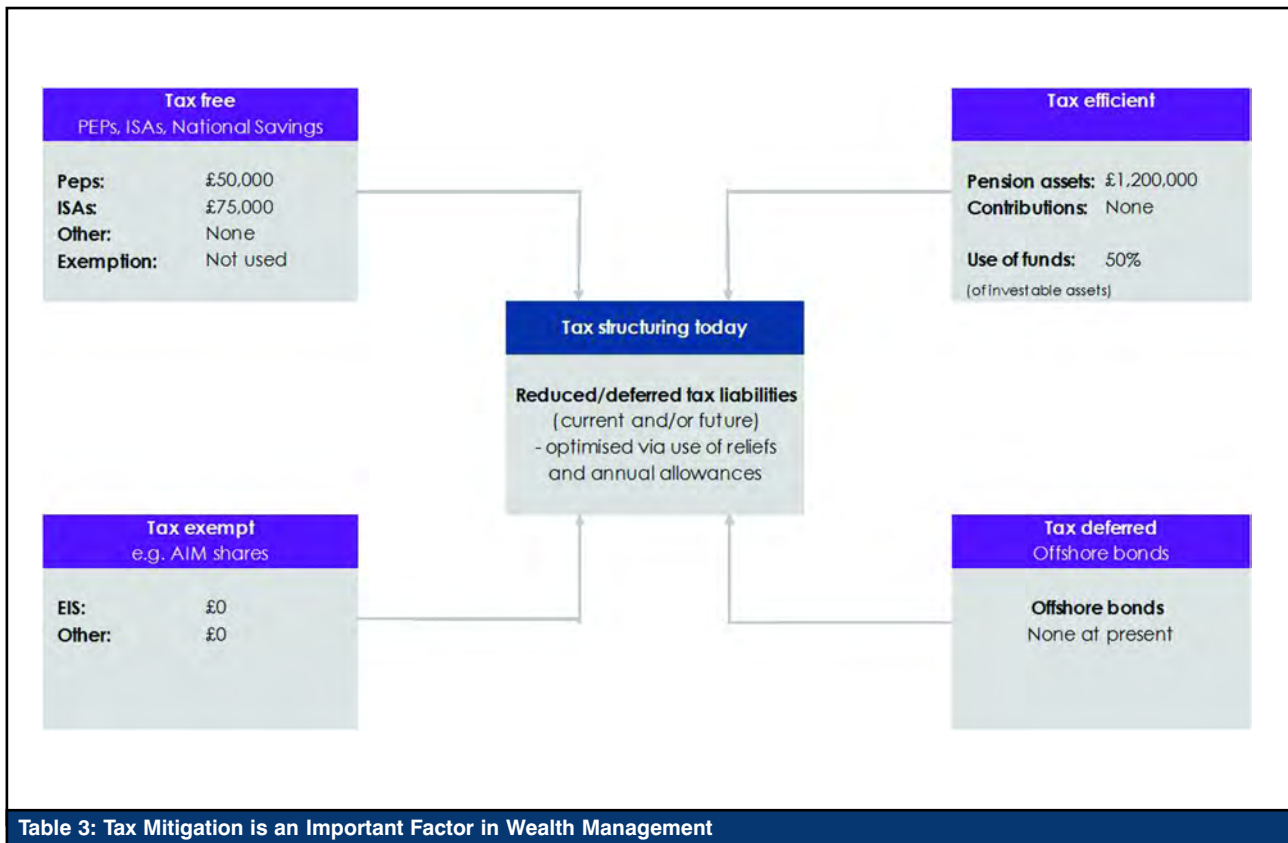


Table 2: Assessing Long Term Goals is Important



of drawing on capital as well as natural income is alien to many wealthy people but it is a more tax and investment efficient way of approaching the management of your wealth than relying on taxable income throughout life which is taxed at 40 per cent and then a further tax of 40 per cent payable on your eventual death on the remaining capital, particularly as capital gains tax is 18 per cent from 6 April 2008. Also, it is arguably better to use your wealth for the things that are important to you in your lifetime than leaving it up to your executors.

We might also agree to completely disregard your property business for the purposes of meeting your goals, on the basis that this is the most prudent approach. We can then calculate the ability of your investible capital to meet your cashflow needs and other goals. The result is identification of the real rate of return, that is the amount over inflation that you need your capital

to achieve to fund your goals. However, the required real rate of return will be different depending on which goals we are seeking to fund. For example we might be able to fund your 'Required' goals with a 2.5 per cent per annum real return, whereas including the 'Desired' goals might push this up to needing a 3.0 per cent real return and including 'Aspirational' goals might push it up further, to say 3.5 per cent per annum real return.

Risk capacity and investment strategy

Without knowing your risk capacity and desired expenditure it is difficult to suggest a suitable investment strategy. However, you need to start thinking in terms of the 40 years or so of your life expectancy rather than the 10 year period until you cease paid work. This change in time perspective will better enable you to plan and mitigate probably the biggest risk – inflation.

Cash has, historically, been a very poor store of value and inflation is likely to seriously erode the value over the longer term. You need to hold, therefore, sufficient cash to allow you to:

- meet immediate and short term capital spending;
- which allows you to 'sleep well; and

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- which provides a sufficient buffer to allow you to vary the rate at which you make withdrawals from the main portfolio.

The balance can then be allocated to a diversified investment portfolio. Equities are risky but over 20 years or more they have historically offered the best hedge against inflation. The dividend income provided by equities has historically been much more stable than interest arising from cash and gilts, whereas the capital volatility from equities has been very high compared to cash. What you need is a spread of different types of equities, property, shares and some

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liquid commodities exposure. This will give you the highest expected return for the lowest level of risk and is called diversification.

A risk profile assessment helps us to understand your ability to accept investment uncertainty relative to the general population and also relative to your own perception.

The service we use is provided by market leaders Finametrica and you can do an assessment yourself online for a small fee at www.myrisktolerance.com. If your risk profile matches the 'average' investor, then an allocation split 50 per cent to growth assets (such as equities, property and commodities) and 50 per cent to defensive assets (such as short dated bonds, index linked gilts and cash type investments) has a very high probability of producing a real return (that is, after inflation), net of tax and charges, of in excess of 2.5 per cent per annum. Under this asset allocation, you could probably expect to take withdrawals from your overall portfolio of about 3 per cent per annum and increase them over time to compensate for inflation, with a very high likelihood of the capital

not being exhausted in your life time (which might be as much as 50 years).

On this basis, if you allocated, say, £1m to the cash reserve, the remaining £4m allocated to the portfolio could provide an inflation protected 'income' of about £120,000 per annum. A higher 'income' might be possible if you were able to accept a higher risk or allocated more capital to the portfolio whether that be at outset or from surplus profits arising from the property business.

Whatever allocation you choose, it is imperative that the portfolio is re-balanced back to the original asset allocation whenever the portfolio moves significantly out of line. This forces you to sell off assets that have risen and buy more of those that have fallen in value, which is the opposite of what most individual investors do. There is no real consensus on when one should do re-balancing but we suggest taking action whenever the individual asset classes exceed 10 per cent of the original allocation.

Tax structuring and inheritance tax

Minimising the main taxes - income, capital gains or inheritance tax (IHT), is a tangible and desirable benefit which means you and your family get to keep more of the investment returns created. The key is to structure your wealth such that it minimises tax in the short and long term based on the most likely assumptions about your needs, investment growth and changes to your circumstances, that is moving abroad and so on. Because tax rules change all the time, you might prefer to employ a diversified tax management strategy, so you do not rely too much on one approach. Table 3 shows the key tax shelters which might be included in your plan.

Disaster planning

Insurance has a place in your wealth plan whenever you have insufficient resources to meet your needs in the event of illness or

death or if it would be a better use of the family wealth to pay such premiums than use up resources in the event of such an event occurring.

In wealthy families the most common use of insurance is whole of life assurance written under a flexible trust for the benefit of heirs, to provide some or all of the capital which would be lost to inheritance tax. The cost of such cover is usually very low for the

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first 10 years, as long as you are in good health, and might provide you with some flexibility to decide what more substantial IHT planning you might undertake at a later date.

Pulling it all together

Having a clear idea of what you are trying to achieve and quantifying whether your financial resources are sufficient are key to devising a successful wealth plan. Investment and tax planning decisions can then be made in context and based on what has the highest likelihood of success and provides a disciplined framework for keeping on track. That way you can focus on really getting the most out of life and leave investment markets to take care of themselves. ■

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