What lies ahead: The "life cycle" approach to financial planning

After you have examined your financial situation, that is, measured your net worth, and calculated your income and expenses, you can start developing your personal financial plan. To help you do this, we thought you might find an overview of the five stages of an adult's financial life useful. That way, you can see where you fit in and have some idea of what lies ahead.

Keep in mind that everybody's circumstances are unique. Not everyone will experience all five phases in the same order and some will skip a phase altogether or start a phase sooner than the norm.

Phase one: Starting out

This first phase begins after the college or university years. Most people start their first job and move into their first apartment. It's the beginning of a career and could entail a lot of capital spending on mundane household items. Cash inflow is meager, while cash outflow is usually large. This is an easy time to get into financial trouble through overspending. A key word at this stage could be "budget".

While it may be difficult at this stage to save, a portion of income should be set aside, if only to introduce discipline into your life. Big purchases should not be made on credit. In terms of investments, GICs may be too boring, while option and commodity trading may have more appeal. This is a time for adventure, and speculative trading may fit in with this adventuresome spirit. Risks should not be open-ended, though, and should be limited to an affordable amount. But, while emotionally you may be ready and willing to speculate, there's usually one "small" problem: lack of funds.

A savings plan could be used to accumulate funds for risky investments. It's probably the most appropriate time for speculative trading because losses will not affect retirement planning drastically at this point in time. As well, any losses that do occur will have a sobering influence on the novice investor.

This isn't to say that people start their investing lives by going on a speculative binge. It always makes more sense to start slowly. As you gain experience and knowledge, you can move on to more complex and speculative investments.

Phase two: Marriage, mortgage, children

The late twenties to early forties phase is characterized by a series of important milestones. This is the time of our lives that usually includes getting married, buying a house and starting a family. Investors tend to be more adventurous at this stage, but more responsibilities are being taken on. Work or job-related activities take on more importance and leisure time activities tend to be replaced by house maintenance and family outings. Switching from freedom mode to family mode brings financial responsibilities and constraints.

Those who have started their $50 per paycheque plan may now have greater difficulty in saving, as there's always a new lawnmower, air conditioner or other household expense popping up. In fact, what little has been saved may already be spent. But, maintaining this type of plan is more important than ever, if only for vacations and emergencies. Maintaining the discipline of saving regularly is vitally important as well.

Savings can be invested in various ways, although for most, a high degree of liquidity is necessary to cover emergencies and other contingencies. Speculative investments are usually not liquid and any speculating should be viewed as an expense, rather than an investment. It has to be the money that will cause little or no hardship if lost.

It's also time to start saving for your children's education. Whether or not one chooses a Registered Education Savings Plan, putting money away now, when the children are young, will certainly mean that

All pre-written articles are for the exclusive use of practising FCSIs and remain the property of CSI Global Education (2003). Unauthorized use or duplication of these articles by persons who are not practising FSCIs is prohibited and subject to penalties provided by law.

© CSI Global Education Inc. (2003)

paying for college or university later on does not break the bank.

If you haven't started saving money on a regular basis yet, it's not too late to start. These habits should be well developed before moving into the next phases of life cycle, when retirement and investment savings become more important than ever before.

Using cash instead of credit, whenever possible, is key. While credit, like a credit card, line of credit or overdraft protection at your bank, is often necessary, you should avoid using this protection if you can. This isn't to say that credit is inherently evil. The fact is, just about everyone, except the independently wealthy, will need credit at some point in their lives. The key word here, however, is temporary. The problem with credit is that far too many people rely on it as a way to live beyond their means indefinitely.

Phase three: The "core years" – Moving up financially

The years from 40 to 55 are peak income years, but they could also be the most difficult. Mid-life crisis, depression, divorce and other personal problems are most likely to occur in this phase. The mortgage may be paid off and the children finishing college, but there can also be a possibility of job loss. This period of life often becomes a time for taking stock, as people look back over their lives to see what accomplishments and goals have been reached. For some, career changes or financial upheavals can occur.

At this point, many financial responsibilities, such as children's education expenses and the mortgage, are paid off. This may be the first opportunity that most people have to really save money for investment and retirement purposes. One of the biggest mistakes made at this point is taking too much risk in an effort to make up for lost opportunities. This is unwise. Investments should be reasonably conservative, with speculation taking a back seat. Money should increasingly be put aside for retirement purposes into RRSPs and company pension plans.

Phase four: The "peak years" – Arriving

During the years from 55 to 65, investors usually have an unprecedented opportunity to add to their nest eggs. Earnings should be at or near their peak, while expenses, especially the ones required to raise a family, continue to dwindle. From an investment viewpoint, this should be a time to top-up any financial plans. RRSPs should be maximized, and other tax savings plans initiated, so that every dollar counts. Investments should be increasingly conservative. You are getting close to retirement and may not have the time to ride out a major down cycle in the market. If assets are large, plans for their distribution should be finalized.

At this point, those who have still not started a regular savings plan may decide to invest what little they have accumulated in risky, go-for-broke ideas. This is foolhardy. Few investments can really make up for lost time and any investments should be well considered. Losses should be taken seriously, as there's no time to allow for recovery. If funds for retirement do not look adequate at this point, now is the time to make contingency plans. What can you do after retirement that can provide you with the funds you need? How can you arrange your affairs now to ensure that you can carry out those contingency plans?

Phase five: The "calmer years" – Retirement and beyond

If you have followed the kind of plan we've talked about, the post-retirement years should be less stressful. However, as regular expenses drop, new ones may appear. For many of us, working minimizes the idle time that could otherwise be spent on buying things. In addition, hobbies such as travelling, collecting, gardening and spending more time with family and friends can add up to more than you anticipated.

All pre-written articles are for the exclusive use of practising FCSIs and remain the property of CSI Global Education (2003). Unauthorized use or duplication of these articles by persons who are not practising FSCIs is prohibited and subject to penalties provided by law.

© CSI Global Education Inc. (2003)

Your investments should include enough liquidity to provide for cash needs. Your investments should be primarily conservative. But remember inflation is the sworn enemy of anyone on a fixed income. Your returns should be monitored against inflation's erosive effects on a regular basis. The volatility of interest rates is another reason you should keep your assets diversified.

The life cycle approach to financial planning can help you develop a suitable range of investments. There are some situations common to us all at certain stages of life and the life cycle approach can be useful in putting together an appropriate investment strategy. But, as with other aspects of investing, there is a lot more to financial planning than the life cycle approach. So, don't be uncomfortable asking for help. It is your financial future after all that you are trying to secure.

All pre-written articles are for the exclusive use of practising FCSIs and remain the property of CSI Global Education (2003). Unauthorized use or duplication of these articles by persons who are not practising FSCIs is prohibited and subject to penalties provided by law.

© CSI Global Education Inc. (2003)