Traditional investment, financial planning can be disastrous to your wealth

BUILDING WEALTH BY CHRIS SNYDER & HUTCH ASHOO

Your team of East Bay business experts

We have heard and seen many stories over our 18 years as wealth managers: widows and widowers forced to reduce their retirement income by 30 percent to 50 percent to make their wealth last their lifetimes; retired couples having to sell their homes when their financial plan went awry; entrepreneurs and senior executives who postponed spending time with their families hoping to retire early only to realize late in the game that they had several more years of work ahead of them.

Take-aways
- Don't build a plan on flawed assumptions.
- Stress test your financial plan.
- Use diagnostic tools to help forecast potential pitfalls.

We can blame the financial failures on "the market," economists, market prognosticators, bad luck. But these are nothing more than scapegoats.

What disturbs us about seeing lives shattered is that usually it didn't have to happen. The potential pain was identifiable long before "irrational exuberance." And people could have been prepared.

All of the investors we described relied on financial advisers, professionals trained to prepare traditional investment plans.

Each identified his or her risk tolerance and optimized asset allocation.

Each prepared a financial plan. But, dusted off several years later, those plans – like many based on erroneous assumptions – look pretty silly.

Each received quarterly reports of portfolio performance relative to market indices. Each followed the rules of conventional wisdom, which proved unwise.

Think about the senior executive nearing retirement. Five years ago when he was 55, his adviser projected his retirement plan based on a "conservative" 11 percent return assumption. Next year, at 61, he was supposed to be able to stop work with $2.68 million and enjoy an annual income of $148,000.

We know that the pain, the fear and the reality of market ups and downs can be anticipated and planned for.

He skipped a family vacation and took on additional work. After all, he was anticipating retirement and would soon have plenty of family time.

Over the past five years, the market's performance was nowhere near 11 percent. In fact, his portfolio is now worth $2.23 million. A year from retirement, his family eagerly awaiting their time together, he got the bad news. His financial adviser updated the traditional plan: Based on the market declines and his assumptions, he would go broke at age 82.

His financial adviser gave him two alternatives. He could retire next year and live on $125,000 a year – $23,000 less than originally planned. Or he could work two more years and spend his principal in later years.

Some choice.

Our executive's plan had a high chance of failure from the beginning. High probability stress-tested wealth management plans contemplate the reality that the market goes up and down. They plan for the impact of short-term market movements on long-term plans.

A trained wealth manager would have shown you that in all likelihood the changes the traditional plan did not expect were not only possible but highly probable. Isn't that what a long-term plan should contemplate?

The difference between a stress-tested high probability wealth management plan and a traditional financial plan or money management is that high probability plans contemplate the possible impact on your wealth of many contributing risk factors.

If you truly value your financial health, you might reconsider whether leaving your financial future to traditional financial or investment plans is very wise.

Do you think our senior executive would have made the promises and emotional commitment to himself and his family if he had known he had a 4 in 10 chance of running out of money in retirement? Or if he had known that he had a 59 percent chance of reaching his $2.68 million goal by age 61?

We know that the pain, the fear and the reality of market ups and downs can be anticipated and planned for. Current diagnostic tools can help identify these financial disasters in advance. Your best course of action requires skill, knowledge and wisdom. This is what wealth management and stress tested high probability plans are all about.

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