

What is your biggest financial risk?

By Phillip Win (Director and Senior Financial Planner, Profile Financial Services)

Our biggest financial risk of all is the risk that we will run out of money before we run out of life! It's a topic that is rarely discussed (perhaps in the hope that if we don't talk about it, it won't happen?), but I have found it is often on the mind of clients.

Too often, we only hear what we want to hear and we tend to seek out those people who affirm our thoughts and beliefs rather than challenging us.

Who would you prefer to engage as your financial adviser?



Adviser A - who tells you that you cannot retire yet, or continue to spend at the levels you are spending, as you will run out of money and be on the aged pension; or



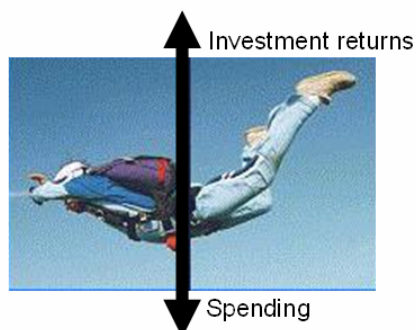
Adviser B - who has a great scheme for delivering above-market investment returns, and if you ask what happens if results aren't as good as expected, tells you "we'll cross that bridge when we come to it."

Unfortunately, there are many financial advisers who prefer to deliver good news and are willing for their clients to risk running out of money, rather than confronting the client with the fact that they are spending too much money or they do not have enough capital to support the income they wish to draw.

The moment of truth

There have been numerous occasions where a client has come to see me later in life after having been with another financial adviser for many years. Their trigger for seeking a second opinion is that they have just realised that they are going to run out of money. They ask me - is there anything that I can do to stop this, or at least slow it down? Often their adviser had never raised the issue until confronted by the client, upon which they acknowledged that it was a probability the client would run out of money and that they may have to wrestle with the idea of being totally dependant on the Aged Pension.

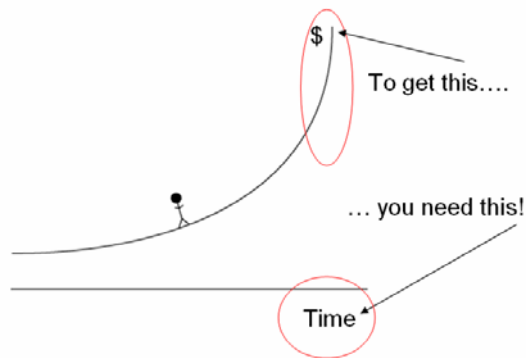
Terminal velocity



There is a point where anyone's investment capital can reach what I call "terminal velocity." By this, I mean that no matter what you do by way of reducing expenses, changing your investments etc, your capital will be depleted. The inevitable result is full dependence on the Age Pension, which is currently \$329.20 per week for a single person. This would be a huge compromise in lifestyle for a professional dentist!

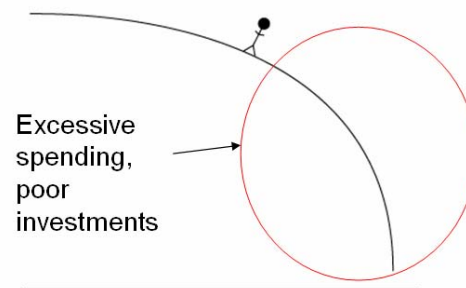
Many professionals, used to earning significant amounts and spending what they please, struggle to believe that this could ever happen to them. However, spending too much, starting too late, and then making poor investment decisions in a desperate attempt to make up the shortfall can all compound in a very few years to this very situation.

Compound interest – and compound decline



It is not enough to merely save money in a bank account. Yes, it is an admirable start, but not enough to achieve financial independence. The 8th wonder of the world is **compound interest** and it is this phenomenon that allows your money to work smarter, not harder. A regular and disciplined approach, using investments that deliver a good and consistent return above inflation, will pay off handsomely over time.

The evil twin of compound interest must also be acknowledged. This occurs in draw down phase and can erode your investment capital in a matter of a few short years. This was the reason why the Federal government relaxed the amount of money allocated pension recipients had to draw from their account balance during the global financial crisis. Sadly, people were being forced to sell investments at falling prices in order to meet statutory pension payments that had to be drawn. This had a compound effect (in reverse), resulting in the rapid erosion of investment capital.



Avoiding the perils of longevity risk

Profile's approach to investment strategy is called **Objectives-Based Investing (OBI)**.

In essence, we have developed an investment modeling tool whereby our clients are able to input their requirements for future living expenses and capital requirements (car, holiday etc), and how long they wish their capital to last. The model combines these with expected rates of return from various investment strategies and then provides an appropriate portfolio allocation to achieve those objectives. If a client's objectives are unlikely to be achieved, the tool can show various different outcomes

using different levels of investment risk, and different timings and spending amounts for investment objectives, until a match is achieved that the client is comfortable with.

At Profile we do not “label” clients with a psychological tag of conservative, balanced or aggressive. In our view, psychology and passively tracking markets are a poor basis for an investment strategy – no-one likes to lose money! Each Profile client has their own unique allocation to a selection of investment portfolios that are managed to achieve their unique investment objectives in the timeframe that’s important to them.

Tailored investment portfolios

There are four main portfolios that are mixed and matched to meet each client’s unique needs:

1. The **liquidity portfolio** ensures clients have enough cash to meet their day-to-day living expenses for an agreed period of time (usually at least three years), without the need to sell assets in a down market and realise losses.
2. The **preservation portfolio** is designed to preserve capital and deliver a solid return above inflation over at least 3 years
3. The **accumulation portfolio** is designed to generate a higher return above inflation using a 6 year time horizon, for those clients who need to take on more risk to achieve their goals.
4. The **acceleration portfolio** is for those clients who have sufficient capital to meet their expected lifestyle needs, and are looking to drive stronger long-term investment returns. It includes unique, often liquidity constrained investments that aim to beat cash by a good margin over longer periods.

All the portfolios are managed with downside protection as a high priority, and aim to achieve their investment objectives, rather than always chasing top returns with a high risk of losing substantial amounts during times of crisis.

Profile’s objective is to empower clients to make informed decisions: by not being afraid to ask the hard questions, and working together to find a solution that is customized for **you**.

About Profile Financial Services

Profile is an independently-owned boutique financial planning firm with offices in the Sydney CBD and North Parramatta. We have operated for over 20 years, and specialise in serving the wealth creation and protection needs of professionals and small business owners. Many of our clients are dentists, and we run regular education seminars on financial planning specifically for dentists. To find out about upcoming seminars, or to book an obligation-free meeting with a Profile planner, call Aine Love on 02 9683 6422 or email aine@profileservices.com.au Website : www.profileservices.com.au