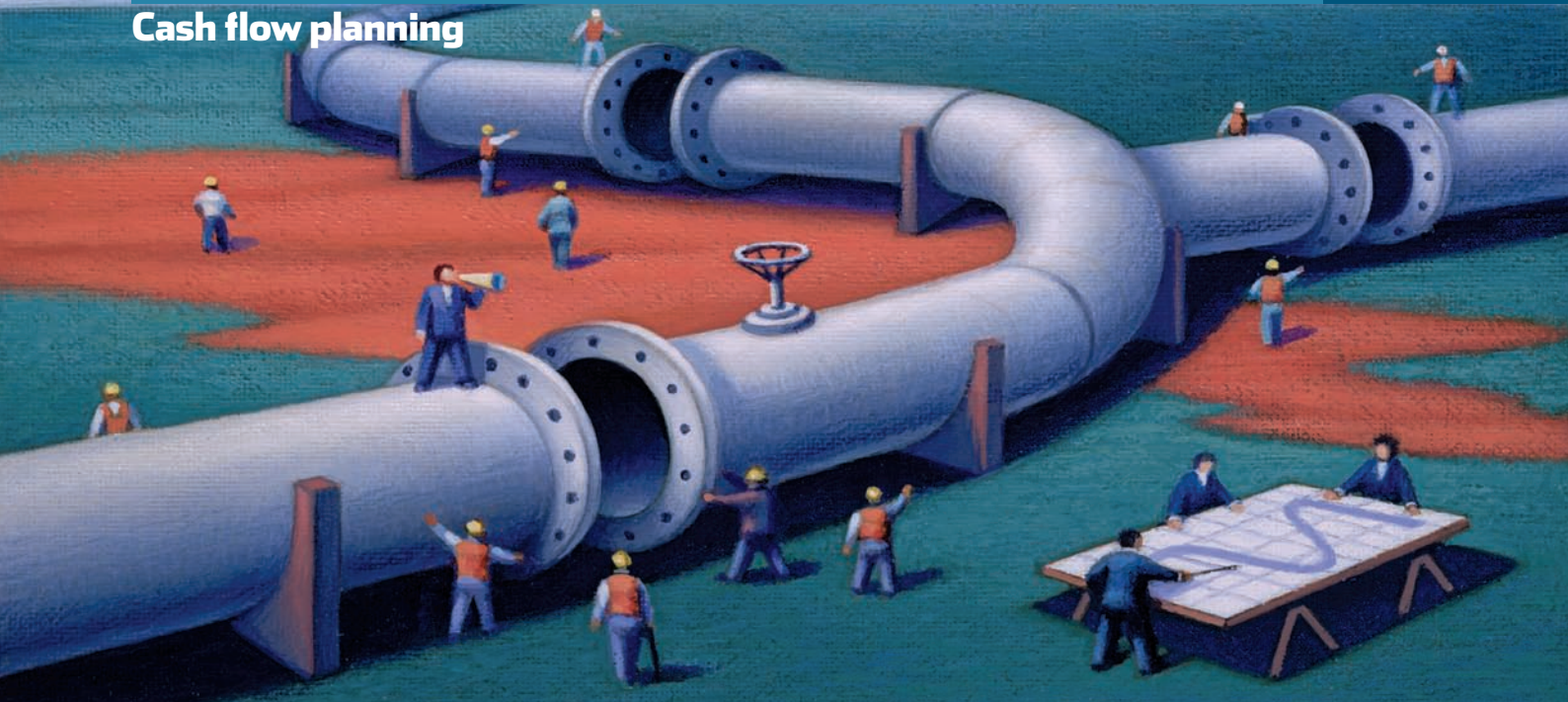




## Cash flow planning



# Capital connection

Financial planners offer a very different service to traditional advisers, in that as well as managing an investor's finances, they also help to structure their desired lifestyle, finds **Faith Glasgow**

If you ran a company, chances are you would employ a financial director whose job it was to create and monitor the budgets and cash flow forecasts forming the basis of the company's business plan. Without knowing the firm's current financial position and projected cash flow, you would struggle to achieve your business objectives – or even to know whether they were realistic.

As Steve Willis, managing director of Piercefield Asset Management, says, the same principles apply to individual clients. 'Before we can create any long-term plan for a client, we need to know where they stand financially and how that's likely to change – which means drawing up a cash flow forecast.'

First, says Willis, the financial planner needs to get an accurate handle on the household's financial arrangements, which are often presented as 'a big bag full of papers' to be sifted through. These include income sources such as regular earnings from jobs, investments and pensions, future payouts from maturing policies, and expenses such as debts repayments,

regular bills and general living costs, as well as one-off outgoings such as holidays or new cars. All the information is put into the cash flow forecast, so, in the words of Julie Lord, wealth manager at Bluefin Wealth Management, 'we can see what we've got now and what will become available and when.'

**"The aim is to build in every bit of income anticipated for the rest of the client's life"**

Assumptions have to be made about inflation and the rate of investment growth. Other variables include expected increases in income, other possible injections of cash (bonuses, for example), and the client's spending pattern.

But the financial planner's role extends well beyond the practicalities of cash flow to helping clients work out what they want to achieve in the future. 'When do they want to stop working? What do they want to do in retirement? Some have very clear ideas, but others are much less specific; it's our job to help them clarify their thoughts,' says Lord. However, adds Willis, this process is very much an ongoing exercise:

'in many cases, people's ideas emerge and evolve over time.'

### Build in income

The aim, says Lord, is to build in 'every bit of income anticipated for the rest of the client's life, plus expenditure now, and future expenditure that their desired lifestyle will involve.' The resulting cash flow highlights any gap between the client's projected financial future and aspirations. Then it's possible to see how adjustments can be made to bridge that gap, for example by reducing expenditure levels, increasing the amount of risk they're prepared to take or accepting a less ambitious vision of the future. 'It means you're not just bumbling aimlessly along hoping your finances will turn out OK in the end, like most people do,' Lord comments.

The cash flow forecast can be run and re-run to take account of different scenarios such as the sale of a business, the death of a spouse, redundancy or nursing home fees. Of course not everything will come to pass, but 'this way clients have a real idea of what the future potentially holds and how they'll deal

## Cash flow planning

with it,' says Jane Wheeler, principal of Direction Financial Planning.

### Practical reassurance

Moreover, when external forces are wreaking havoc on investors' portfolios, the cash flow forecast may provide practical reassurance that they are still on target, because there was leeway in the first place or because the timescales involved give enough opportunity for portfolio recovery.

So what does cash flow planning mean as far as product recommendations are concerned? Existing holdings may be streamlined to simplify and tidy up a portfolio. But often no purchases are involved because clients don't need anything more.

'We are not driven by transactions, so if you're on target for your financial goals we won't make unnecessary changes,' stresses Willis. 'We certainly don't take it as read that you need a corporate bond Isa this year, or a certain amount of life cover, because we look at the wider picture of the financial situation. Why would you need corporate bonds if you can achieve your financial objectives with a less risky alternative?' That's a particularly attractive argument for older people, who are often quite happy to minimise their investment risk if they can get away with it, says Wheeler.

The aim of financial planners such as Willis, Wheeler and Lord, then, is not to compete with conventional IFAs by providing financial products that meet clients' immediate needs, but to take a much more holistic, long-term approach to try and make sure that their finances are in step with their long-term plans and dreams, and remain there as circumstances change over the years.

Of course, financial advisers argue that they carry out a detailed 'fact-find' and work hard to ensure clients' needs are properly catered for. But, responds Lord, 'unless you know what the future holds, it's all guesswork based on affordability and rough rules of thumb. Investment portfolios are a case in point. Advisers create portfolios for clients, based on risk profiles and so on, but those portfolios are never designed to achieve a specific rate of return that will meet the client's lifestyle goal.'

What about cost? This kind of intensive analysis, unrelated to product sales, has to be carried out on a fee basis and it doesn't



**"[Planning] would almost certainly pay for itself several times over"**

## AVAILABLE THROUGH ADVISERS: Morgan Stanley FTSE Defensive Gilt-Backed Growth Plan

### Alan Lakey, Highclere Financial Services

Morgan Stanley has reacted to concerns of investors and advisers over the solidity of the guarantees underpinning structured investment products. Its FTSE Defensive Gilt-Backed Growth Plan is a three-year investment promising growth of 9 per cent a year, subject to the FTSE 100 not having fallen by more than 10 per cent at each anniversary. This rate is not compounded, so the maximum growth after three years is 27 per cent. Return of capital is guaranteed unless the FTSE falls by more than 50 per cent at maturity.

The plan is unexciting, and capital is at risk, but it may prove attractive with cautious investors who believe the worst of the market falls are behind us. But with potential gains capped and the capital not fully guaranteed, investors may prefer the greater potential a blue chip unit trust or open-ended investment company is likely to provide. Nonetheless, this may prove a worthwhile portion for a balanced portfolio.

Investors should also consider Investec's five-year FTSE 100 Plan 7, which guarantees return



Alan Lakey

of the capital plus growth within the FTSE 100 capped at 50 per cent of the investment. Investec's guarantee is predicated on its own continuing solvency and no doubt Morgan Stanley will point to their gilt backing as superior.

### Kelvin Lillywhite, Albany Financial Services

This plan appears to offer clients the advantage of a structured investment product, but uses gilts and cash to reduce investors' reliance on the creditworthiness of the underlying issuer (that is, Morgan Stanley) for guarantees backing it.

If we take everything at face value, with gilts providing greater capital guarantees than comparable products, then we need to consider the returns the

client is likely to get and whether the plan will run to maturity.

The offering of 9 per cent growth for each year invested does seem very attractive for cautious investors, especially given that this return could come even in a market that dips slightly.

Clients will, of course, lose out if the market increases by more than the amounts paid out. The product offers potentially a good return in a short space of time; it is substantially different from many other plans available. As with all structured investments, advisers really do need to ensure they understand the true nature of any risk. Other products offering similar returns have already proved they work and are well understood.




Kelvin Lillywhite

come cheap. Even clients with straightforward affairs should expect to fork out upwards of £1,000, says Wheeler, and those with complex financial situations could pay nearer to £3,000. You should be given an estimate of the likely cost at the outset of any consultation.

don't meet long-term objectives, adds Willis.

Annual reviews involving updated cash flow projections are important, although for many clients these costs are covered by the typical 1 per cent annual charge levied for investment management. Clients whose investments are not handled by the planner will pay an hourly rate for annual reviews.

Cash flow management sounds a grown-up and sensible approach to personal finance, yet few UK consumers have ever heard of it. 'Everyone should do it - people could do it for themselves, although it's a lot easier with the software, knowledge base, experience and objectivity that a professional outsider can bring,' says Willis. 

### Saving money on tax

However, adds Lord, the planning exercise 'almost certainly would pay for itself several times over'. She says clients usually save money on tax, particularly inheritance tax: 'Forecasts give families huge amounts of reassurance, so they feel able to give money to their children.' The process of rationalisation may also mean savings, as clients are no longer buying products that

To find a financial planner who specialises in cash flow forecasting, contact the Institute of Financial Planners: [www.financialplanning.org.uk](http://www.financialplanning.org.uk)