# Financial Planning Basics

## An Overview of the Financial Planning Process

PREVIEW

Good <MORNING, AFTERNOON, **E**VENING> and welcome. My name is <YOUR NAME>, and I represent <FIRM NAME>.

In this presentation, we'll take a look at some general financial planning concerns. While there's no such thing as a "one-size-fits-all" financial plan, this overview should assist you in thinking about your own needs.

[V23N1]

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## The Ground to Cover

- Setting goals
- Budgeting
- Emergency fund
- Insurance
- Using credit
- Investing
- Tax planning
- Saving for college
- Retirement planning
- Estate planning

PREVIEW

There's a lot of ground to cover, even with an overview. Here are the topics we'll touch on:

<CLICK> We'll talk about setting goals; doing so is really the first step toward developing any financial plan.

<CLICK> Then we'll discuss constructing a budget

<CLICK> and creating an emergency fund.

<CLICK> Then we'll touch on insurance protection.

<CLICK> In many cases, you may need to incorporate credit into your financial plan, so we'll discuss some credit fundamentals.

<CLICK> We'll also talk about some basic investment concepts,

<CLICK> and how understanding pre- or after-tax allocations, along with tax-deferred growth, can help you pursue your goals,

<CLICK> such as saving for college

<CLICK> and planning for your retirement.

<CLICK> Last, but certainly not least, we'll look at the rudiments of estate planning. So, let's get started.

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## Setting Your Goals

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One of the first steps in financial planning is setting goals. When you set goals, you're defining your dreams for the future. Some of your goals may be things that you want to do in the not so distant future, like <CLICK> pay off your credit card debt or <CLICK> buy a new car. Other goals may be more distant. Do you want to <CLICK> buy or build a new home? <CLICK> Start your own business? <CLICK> Pay for college for your child or grandchild? <CLICK> Retire early?

Your goals are the foundation of your financial plan because you need to know what you want to accomplish before you can begin saving or investing. Once you've identified and prioritized your financial goals, you can develop a clear-cut savings or investment strategy that can help turn your dreams into reality.

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# How SMART Are Your Goals?

- **S**pecific
- **M**easurable
- **A**ttainable
- **R**elevant
- **T**imely

Write down and prioritize your goals.

PREVIEW

Making your goals as concrete as possible will help you focus on what's really important. A goal that's well defined will be easier to visualize, and easier to stick with.

<CLICK> To set clear-cut goals, you can use the SMART technique. SMART is an acronym that stands for specific, measurable, attainable, relevant, and timely.

<CLICK> A goal that's **specific** is one that's clearly defined and described in detail. Precisely, what do you want to accomplish? "I want to save for my child's college education" is not a specific goal, but "I want to save the cost of 4 years at Homegrown U. by the time my daughter turns 17" is clearly defined.

<CLICK> With a goal that's **measurable**, you should be able to track your progress and clearly know when you've reached it. For example, "I want to retire early" is not a measurable goal. But "I want to retire by my 55th birthday" is a goal that has a definite endpoint.

<CLICK> An **attainable** goal is realistic and reachable. Goals can be challenging, but you should have a fair chance of achieving them. "I want to save $1 million in 5 years" is not an attainable goal for many people, but "I want to save $1 million in 30 years" may well be an attainable goal.

<CLICK> A **relevant** goal is one that makes sense to you, and that reflects your specific needs and your values. Goals that are relevant are goals you will be excited about because they will be important to you. For example, "I want to save $25,000 for a down payment so I can own my own home" is an example of a goal that might be relevant.

<CLICK> You must be able to set a **time** frame or deadline for reaching your goal. "I want to pay off my credit card debt by the end of next year" is a goal that has a clear deadline.

<CLICK> Writing down and prioritizing your goals is an essential first step towards putting a financial plan into action.

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# Budgeting

Income
1. Paycheck
2. Rental income
3. Government benefits
4. Interest
5. Investment income

− Expenses
1. Fixed expenses
2. Discretionary expenses

= Surplus

PREVIEW

The first part of putting any financial plan into action requires you to control your flow of money. That's part of what a budget is all about. A budget tracks your income and expenses, and helps you direct the flow in the way you want it to go.

<CLICK> To construct a budget, first account for all your income. This includes your paycheck, plus any income you might have from other sources such as rental income or government benefits, interest on money you have in the bank, or investment income.

<CLICK> From that, you'll need to subtract your expenses. Expenses can be broken down into two categories. Fixed expenses are those you pretty much have to pay, such as rent or a mortgage payment, car payments and insurance, utilities, groceries, and basic clothing. Discretionary expenses are more optional items, such as eating out, entertainment, gifts, and vacations.

It can be difficult to get a handle on many of these numbers, especially the expense items. You may want to keep track of them for a while, either with a paper and pen or on a computer software program, to find out how much you're spending. And remember that not all your expenses occur on a weekly or monthly basis. Some are seasonal, like holiday gift expenses or home heating costs. Others are occasional, like car repairs or getting a cavity filled. It may take several years of tracking some expenses to get a good idea of what you spend on average per month or year.

<CLICK> Now, subtract your average expenses for a given period (a month or year) from your income for the same period. Is there a positive number left over? If so, you're "in the black" or running a surplus. A surplus can be converted into savings or an investment for the future.

<CLICK> But if you get a negative number, that's bad; you're "in the red" or running a deficit. You're spending more than you're making. The only thing that's going to change that equation is either increasing your income (perhaps a second job) or decreasing your expenses (and it's the discretionary expenses--the "fun stuff"--that are easiest to reduce)--or both.

So, let's look on the bright side: you're running a surplus. One of the first things you want to do with that surplus is create an emergency fund.

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# An Emergency Fund

An emergency fund is the foundation for any successful financial plan.

Where you keep your emergency fund is important

PREVIEW

<CLICK> An emergency fund--money that's readily available to meet unexpected expenses--is really the foundation for any successful financial plan. Without money to fall back on when an unexpected expense crops up, you may be forced to tap savings that you've earmarked for retirement, college, or another savings goal. But if you have an emergency fund, it will be much easier to handle a job loss, temporary disability, or other event that might prevent you from saving for the future or even tempt you to pile up debt.

<CLICK> How much should you have in your emergency fund? A popular rule of thumb is that you should have an emergency fund equal to three to six months of your living expenses. But should you save three months, four months, five months, or six months worth of your expenses? The amount you should have depends on many factors. How stable is your income? Do you work in an industry where layoffs are common, or are you in a growing field? Do you have adequate health and disability insurance? Do you have other assets that you could tap without penalty in an emergency?

<CLICK> Where you keep your emergency fund is also important. In a jar is probably not the best idea. You'll want to keep your money in an account where it's readily available, but you'll also want to receive as high a return as possible.  Rarely do you write one check equal to six months or even three months' worth of expenses, so you may only need part of the fund in something as liquid as a savings or checking account.  The balance of the emergency fund can be held in something getting a better return, but that you can still access in a day or two.

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# Risk Management with Insurance

Common types of insurance that help protect you and your assets from different risks:

- Health insurance
- Auto insurance
- Life insurance
- Property insurance
- Liability insurance
- Disability insurance
- Long-term care insurance

PREVIEW

Another important part of financial planning is identifying and managing the potential risks that can impact your finances. The value of insurance is that it's a cost-effective way to mitigate or share the frequently overwhelming costs of various risks. Let's spend a few moments looking at the types of risk you might want to insure against:

<CLICK> Health insurance helps to pay for medical care when you are sick or injured. Most health-care plans provide basic coverage for common medical expenses, such as doctor visits, preventive care, diagnostic tests, hospital and extended care, emergency services, and prescription drugs.

<CLICK> Auto insurance has two main components: liability insurance and insurance for property damage. Liability insurance provides compensation to persons who would be able to sue you for personal injuries, medical payments, loss of earnings, or damage to their property. Property damage insurance includes collision and comprehensive coverage, which compensate you for damage to your car caused by another auto, or by such things as fire, theft, and vandalism.

<CLICK> Life insurance offers income replacement to your survivors. It can provide an income-tax-free death benefit,  and can be used to pay for funeral expenses and even medical expenses of a last illness. The cost and availability of life insurance depend on factors such as age, health, and the type and amount of insurance purchased.

<CLICK> For most of us, our most valuable asset is our home. The most common type of homeowners policy in use today covers a variety of risks that can cause damage to your home and personal property, medical payments for injuries to occupants and to persons injured by accident while in your home, and loss or theft of personal property.

<CLICK> Liability insurance is often your last line of defense against potentially devastating claims for things over which you may have little or no control. It's often called umbrella insurance because it's carried over all other liability insurance and usually adds $1 million or more in extra coverage to your homeowners and automobile liability policies. Coverage is provided for you, your spouse, and any relatives living in your household and insured by your primary policies.

<CLICK> What if you couldn't work for an extended period of time because of an injury or illness? How would you replace your earnings? Who would contribute to your retirement savings accounts or educational funds? Disability income insurance benefits can be used to help preserve your independence, maintain your lifestyle, give you time to recover, provide a chance to retrain for another job if necessary, and conserve your assets and savings for you and your family. A complete statement of coverage, including exclusions, exceptions, and limitations, is found only in the disability income insurance policy. It should be noted that carriers have the discretion to raise their rates and remove their products from the marketplace.

<CLICK> What is long-term care insurance? It's private insurance that pays benefits if you need extended care, such as nursing home care. Like other types of insurance, long-term care insurance helps protect you against a specific financial risk--in this case, the chance that the need for long-term care will wipe out your life savings. A complete statement of coverage, including exclusions, exceptions, and limitations, is found only in the long-term care insurance policy. It should be noted that long-term care insurance carriers have the discretion to raise their rates and remove their products from the marketplace. Additionally, a long-term care policy may not cover all of the expenses associated with a person's long-term care needs.

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# Using Credit

- The three Cs of credit
  - Capacity
  - Character
  - Collateral
- How creditors determine your creditworthiness
  - Credit application
  - Credit report
  - Credit score

"Remember that credit is money"
*Benjamin Franklin*

PREVIEW

Okay, you've established an emergency fund, and you've insured yourself against certain risks to your financial security. And to meet your normal expenses, you've planned a budget. But sometimes you need more funds than your budget might cover at the moment, and that's where credit comes in.

A word of caution here: Don't rely on credit to cover your normal living expenses. If you do, you could be heading down a path that may lead to financial disaster. If you're using credit to pay for normal living expenses, it should be because it's convenient to do so--not because you don't have those expenses planned for in your budget.

<CLICK> Merriam-Webster's dictionary defines credit as "the provision of money, goods, or services with the expectation of future payment." When it comes to financing "big-ticket items" such as a college education, a home, or even a car, most of us will need some sort of loan. And there are many times--like shopping for Christmas or going on vacation--when it's just more convenient to use credit (in the form of a credit card) to make purchases.

<CLICK> So, how do creditors decide to grant credit? It depends on how well you meet the three Cs.

<CLICK> Creditors will want to know if you have the **capacity** to repay the credit they grant you. They'll want to know about your income and your expenses.

<CLICK> Okay, once a creditor determines that you *can* repay a loan, the next question is: *Will* you? This is a matter of your credit **character**. To measure this, they'll look at factors that measure your stability. How long have you had the same job and lived in the same place? And, if you've used credit before, they'll also want to look at your repayment track record. Do you pay your bills on time?

<CLICK> Particularly for loans of larger amounts, like a car loan or a home mortgage, a creditor might also want some **collateral**. Collateral is tangible property that secures the credit extended to buy it; if you default on repaying the loan, the creditor would be legally entitled to take possession of the property as a form of compensation.

<CLICK> Creditors determine your creditworthiness primarily by examining three documents:

<CLICK> The **credit application** you fill out with a potential lender will ask you for your personal information. It will also ask you about your income and its sources, and may ask about your recurring expenses and other debts.

<CLICK> Your **credit report** will give a potential lender a wealth of information about your payment history, and

<CLICK> your **credit score** comes from a statistical formula that analyzes the information on your credit report, compares your profile to thousands of other, similar profiles, and produces a three-digit number that predicts your level of future credit risk.

The information gleaned from these three documents may not only determine whether you can get credit, but also what interest rate and other terms you are offered.

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