

THE CRYSTAL WALL

Although we can help young people as they start their working lives in many ways, most of our financial planning clients are pre-retirees, defined as people in their 50s (give or take a few years) who are still working but can see and be concerned about what the future holds when they no longer work.

The most important tool that we have in our tool box for pre-retirees is our crystal wall. Upon our crystal wall, we can project the futures that might be (think Ebenezer Scrooge in A Christmas Carol). The clients can choose which future they want to create for themselves.

Of course, choosing one's future is not like choosing something for dinner. There are as many constraints as there are possibilities.

Comprehensive financial life planning is the process of connecting one's resources with one's goals. Resources and goals. Remember those words.

Upon our crystal wall we project a client's resources: Savings, investments, social security benefits, inheritances, pensions, etc.

Also upon our crystal wall we project our client's goals: kids' education, starting a business, having a certain amount of retirement income, retiring early – the list goes on.

Then the wall runs 10,000 Monte Carlo simulations to determine the likelihood that a client's resources are sufficient to achieve the client's goals. We aim for at least an 80% probability. All too often the crystal wall projects a probability close to 0%. Then the hard work begins. How do we increase resources (e.g. more savings) and/or decrease goals (e.g., less income in retirement)?

Joe was a young man with a young wife and a couple of kids. He had just entered his high earning years and wanted to make sure that he was protecting his family and was on the path to financial security. He and his wife were hardly pre-retirees. Still, after we had addressed a number of planning issues (estate planning, insurance, tax planning, etc) they were interested in what the crystal wall had to say about their future.

The crystal wall was aware of their resources and goals in a very general sense and predicted that their chances of meeting their goals with the resources they were expected to accumulate given their current actions was zero. We had work to do.

We began by increasing their resources, primarily by increasing their savings. We also tweaked their goals. What if they lived on less in retirement? What if Joe retired later? Each change moved them closer to a match between their resources and goals.

A few months later, Joe e-mailed us that he was not interested in continuing the financial planning process. When we asked why, he stated that we were obviously unprepared for the second meeting. Had we been prepared, we would not have needed to make so many “corrections” to the crystal wall. He was not interested in an explanation of what the crystal wall was meant to do.

When we work with the crystal wall, we manipulate a wide range of variables to see what affect they have on the likelihood of a client achieving her, his, or their goals. I listed many of those variable above (savings, retirement age, retirement income needs). But there are many other factors to consider:

What if the client expects to live to 100? Or only 70?

What if the client’s investments do very well? Or not very well?

What if the client takes social security at 62? Or 65? Or 70?

What if the client sells a home or other real property at some point in retirement?

Contrary to what Joe expected, the crystal ball cannot predict the future. But it can predict the probability of certain outcomes given certain inputs.

But most of all, for many people, the crystal ball is a wakeup call. And usually a call to action.

For others, it brings peace of mind. In the end, when all is said and done, that's the goal of comprehensive financial life planning. Peace of mind.