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FIVE POINT PLAN FOR A PATH TO FINANCIAL INDEPENDENCE

For many people starting on the path to building wealth, the ultimate goal is usually financial independence, meaning that you have enough investment assets to support yourself without needing to work, often before retirement age. In our view, your primary asset to build net worth is your ability to work. While you may be tempted to play the markets, searching for the next Netflix, you and your family will be better off if you take a more balanced approach that begins by protecting your wealth against loss of income due to an unforeseen major change in your personal circumstances such as a major disability or loss of life. These events can be much more damaging than temporary downside market volatility. Once you are certain you are insulated from life changing events, you can focus on growing your investment capital over time.

We recommend anyone on the path to creating material net worth follow these five simple steps as you approach your ultimate financial goals, whatever they may be. Please note that we are assuming you have good health insurance, the very first step that most people should take.

I. SHORT-TERM LIQUIDITY RESERVE (SAVINGS)

The first thing you should do as you build wealth is to build up a cash reserve. This is common sense advice that people followed in the past when credit was not so easy to access, but tends to get overlooked in today's world. If you are single, you should have at least six months of readily available funds to cover your "lifestyle" in the form of highly liquid assets. If you are married with a family depending on your paycheck, you should have at least 12 months of reserves to cover any unforeseen change in circumstances - a job loss, healthcare challenge, birth of a child, sick spouse, etc. If you've considered taking a reduction in your income to join a start-up company, you should ideally have two-three years in reserve. Bottom-line, you need access to liquid savings to avoid putting you and your family in position where you are forced to sell investment assets (possibly at a time when values are depressed) versus having to materially reduce your lifestyle.

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II. LONG-TERM DISABILITY

Once you've built up your cash reserve, when you are young you should ensure that you are able to protect your most valuable asset, which is your ability to earn enough income to support yourself or your family, not to mention to save for retirement. How will you earn a living if you are no longer able to work due to a change in health due to illness or an accident? Most people are not aware that statistically, you are much more likely to suffer a long-term disability than you are to die unexpectedly from an illness or accident. The best tool available to address this risk is long-term disability (LTD) insurance. LTD insurance will pay you in case you suffer a severe healthcare challenge that prevents you from working. Again, if you rely upon your ability to work you need a backup plan should you become disabled. This is extremely important coverage. If you have a partner who works as well, this coverage is less necessary, but you should coverage regardless because you need to plan for the possibility that your partnership might dissolve if you become disabled. No one likes to think of these possibilities, but for your financial security you need to evaluate them nonetheless.

Your employer may offer a LTD benefit, and you should take full advantage of this benefit. However, please note that this coverage will be tied to your job and is often not portable. If your health should suffer while you are relying on this coverage, you may be unable to secure independent coverage. Further, if the premiums paid on your behalf by your employer are not considered income to you, your benefit will be taxable. Therefore, even if you have coverage through work, we would encourage you to find additional outside coverage.

As with any type of insurance, the terms of LTD policies can vary considerably, and the different types of coverage can be confusing. Pay careful attention to the definitions of "disability" and the terms governing the type of work you are considered capable of doing should you suffer a disability. You want to be sure that you have coverage to fund the income shortfall between what you used to earn in your "own occupation" and the amount of income you are able to generate as a disabled person. Lastly, it is best if you pay for your premiums with after-tax dollars to ensure that your benefits are free of tax.

In most cases, family members are unable to answer this question. To be certain you are positioned appropriately, a long-term forecast and analysis is necessary.

III. TERM LIFE INSURANCE

With a cash reserve and LTD coverage in place, the next step is to protect your family against the risk of an unexpected death. Most people do not want to consider their own deaths, but it is a risk you must consider for the sake of your family. Consider what would happen to your family if you were not there to support them. If you are young and single, you probably don't have much need for life insurance, and you can choose to skip this step. But, when you have dependents who rely on your income, you should absolutely take the precaution and protect them. We've seen how difficult it can be for a young family when a provider dies unexpectedly without or with too little life insurance.

Though there are many affordable options for life insurance, low-cost, "term" life insurance from a highly rated company is best. As your net-worth grows, you will probably need less life insurance. So, consider buying a mix of larger policies with shorter terms and smaller policies with longer terms. Staging the insurance this way will give you a good amount of coverage when you need it while greatly reducing the overall cost of insurance. The amount of life insurance you need is dependent upon a number of factors, so it is best to consult a trustworthy advisor to determine the amount of coverage you require.

IV. DIVERSIFIED PORTFOLIO

Now that you and your family are well protected, it is time to consider how to put your savings to work by building a diversified portfolio among a mix of debt, equity and real assets. Establishing an appropriate, long-term strategic asset allocation targets is the most important first step before you put your money to work as your allocation is your responsible for the vast majority of your exposure to market volatility. At this point, simpler is better. Focus on getting broad exposure to the fixed income and public equity markets. Real assets such as commodities and REITs can be helpful for diversifying your investment risks but should not be large holdings for your portfolio. Low cost, broad market ETFs and mutual funds are best for gaining exposure to different asset classes. Focus on tax efficiency by avoiding actively managed funds, and be sure to rebalance as necessary to maintain strategic asset allocation targets. Keep the allocations and investment plan simple. Don't try to "time markets." That said, by being "patient and opportunistic" you can let asset class valuations determine when you should be over or under weight (though never completely unexposed to) different asset classes. If you follow these principles, you will be in a good position to manage your assets and grow your portfolio over long periods of time.

Most importantly, avoid the urge to short cut your way to great performance. Don't buy that hot stock. Don't invest in your friend's brother's cousin's hedge fund that cannot fail. Don't listen to the person at the club who has just invested in the best idea he's ever heard of. Become an educated investor, form a solid, long-term plan and then do your best to stick to it.

V. LIABILITY INSURANCE

As your net worth grows to a material sum, you should take the final step and be sure you have a general excess liability insurance policy. Most people think of liability insurance when they buy a car or a home, but most people fail to insure their net worth against a possible significant liability. If you have considerable assets, including your home, savings, investments or shares in a successful company, you should have an excess liability insurance policy of sufficient size to cover your net worth.

This type of coverage, commonly referred to as an "umbrella" liability policy, is very useful and is not overly expensive. This coverage comes into effect when you suffer a personal liability that exceeds the limits of your regular liability coverage. For example, if you're at fault for a car accident, and you injure someone so badly they can't work, you may be charged with replacing their lost income. This amount can easily exceed the typical $500,000 maximum automobile liability limit. An umbrella policy would be able to pick up the excess liability not covered by your primary insurance. The amount you need depends on your net worth. If your net worth is $5 million, you should have at least $2 million of umbrella coverage. If you have more potential for liabilities to arise, such as having teenage drivers in your household, or if you often host parties, or if you have a swimming pool, you may want to consider a $5 million umbrella policy. If you are the owner of a privately-held company and you have no ability to sell your share of the company, you may want to take out even more coverage to insure against an even more significant loss. Some families with significant positions in privately held stock may have umbrella policies in excess of $10 million.

By following these simple steps, you can build a solid financial foundation for you and your family. You will be on a clear path towards financial independence and will have solid layer of protection against the risks which might derail the financial security of you and your family. When your wealth accumulates to a level where you may wish to consider allocating to more complex investment vehicles, such as alternative investment strategies, and you need to consider more advanced estate planning issues, engaging a competent financial advisor is essential.

For more information, please contact Delegate Advisors at 919-932-8400 or visit our website at *delegateadvisors.com.*

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