Creating a Financial Plan

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Introduction

A financial plan can be comprehensive or narrow in nature. It is a guide to help investors accomplish financial goals such as retiring early, funding college for their children, buying a house, or starting a business. We will look at items to consider when creating a financial plan.

Goal Setting

Establishing realistic goals is an important first step for developing any financial plan. For example, retiring at age 55 is more realistic than retiring at 25. Clearly articulated goals will allow for effective tracking of progress, and any professionals who are engaged can use the information to lay out a strategy and make recommendations for achieving those goals.

Financial planning goals should be updated periodically for life-changing events. Job changes or career transitions are good opportunities to review a financial plan. A change in personal circumstances such as the addition or loss of a family member should also lead to a financial review. Additionally, reaching a goal is an excellent indicator that it is time to revisit a financial plan and see whether a new goal needs to be set.

Budgeting

Developing a budget is a key component to a financial plan because it helps track expenses and can identify areas for cutting costs or increasing savings. A balanced budget should account for all income and expenses and should either be zeroed out or show a surplus at the end of the budget's time period. A budget often is broken out monthly, but it could also be annual, semiannual, or quarterly to account for variable expenses. A budget should be monitored to make sure that it is being followed. As income or expenses change, the budget should be updated accordingly.

A variety of tools are available for budgeting. Many banks and credit unions offer budgeting options on their websites or mobile applications, and there are also budget-specific apps that can be downloaded to a smartphone. Using a spreadsheet or paper tracking also works. The key to budgeting is selecting a method that works for your circumstances.

Retirement Contributions

Retirement accounts are essential for attaining any goal related to retirement. Automated contributions to retirement accounts ensure that they occur regularly, and that annual limits are met. Workplace retirement plans allow paycheck deductions to facilitate regular contributions. If an employer provides matching funds, the employee should contribute at least the minimum amount to receive the full match. In 2025, 401(k), 403(b), and 457 plans allow contributions of $23,500 plus an additional $7,500 catch-up for employees aged 50 and older (those aged 60-63 are allowed a larger catch-up of $11,250); employees should try to maximize their contributions each year to reach their retirement goals.

Individual retirement accounts (IRAs) require the account owner to establish the ongoing savings strategy. Monthly contributions or one-time annual contributions are equally viable methods to fund an IRA. The maximum annual contribution in 2025 is $7,000 with a $1,000 catch-up for individuals aged 50 and older. Traditional IRAs allow investors to contribute pre-tax or post-tax funds and provide

tax-deferred growth, while Roth IRAs allow investors to contribute post-tax funds and provide tax-free growth.

Emergency Fund

As a general guideline, a household with two comparable income streams should maintain an emergency fund adequate to cover three months of expenses. With one income stream or two disparate income streams, a fund equal to six months of expenses should typically be adequate. The emergency fund should be maintained in a liquid, accessible account so that it can be used readily.

Debt Payments

Debt is a necessity for most people, but using debt strategically can help further, rather than hinder, a financial plan's goals. Debt for a home or education is often termed "good debt," while credit card debt is usually labeled "bad debt." Accumulating home and education debt can be unwise if the debtor ends up in a position where he or she cannot afford the monthly payments, or if he or she does not complete the educational component required for career advancement. Credit cards can be beneficial if paid off monthly, but accruing credit card debt is where many consumers dig a financial hole for themselves.

Payments should be made on time to avoid late fees. A debt refinance should be considered when the loan carries a high interest rate or the term is overly lengthy. Interest rates are at historically low levels, so older debt might be a viable target for a refinance; however, newer debt is likely to be at a low rate and refinancing to an even lower rate may not be worth the expense. Individuals should evaluate refinances based on their personal situations.

When deciding whether to make additional loan payments, a consumer should focus on high-interest debt first, such as loans with interest of five percent or more. Maximizing retirement savings and taxable savings accounts should be prioritized over additional payments to lower-interest debt.

Taxable Investments

Investments outside of retirement accounts are taxable investments whether they are bank accounts or brokerage accounts. A bank account is often where an emergency fund is kept. Incorporating a brokerage account into a financial plan offers versatility because the funds can be used to save for short-, mid-, and long-term goals. Brokerage accounts also receive the tax benefit of capital gains treatment on the sale of assets, which can allow for strategic asset sales to minimize taxes. A brokerage account generally should be funded after maximizing all available retirement accounts so that the tax-preferred accounts are fully utilized.

Brokerage accounts should incorporate a long-term investment strategy that coincides with the goals the accounts are targeted to achieve. Brokerage accounts should avoid market timing as it is a very difficult strategy to employ. Market timing refers to an investor buying an asset, seeing the market shifting toward a downturn, and selling the asset with the goal of buying back when the market hits the bottom. The difficult part is that investors must be correct twice: once when they sell the investment and again when they buy back in. It is easy to look back and see where an asset's price bottomed out, but it is difficult to predict it in real time. Many investors lose significant sums of money because their attempts at market timing are unsuccessful, or they never feel confident returning their assets to the market. As a result, they miss out on appreciation, interest, and dividends.

Asset Allocation

Asset allocation refers to how funds are spread across the various investment sectors to create a portfolio that aligns with the investor's risk tolerance and time horizon. A portfolio's asset allocation is often determined via a questionnaire to assess an investor's risk tolerance and timeline on expected withdrawals. These questionnaires are tools to help identify how much risk an investor is willing to bear in their portfolio. Investors with an aggressive risk tolerance and/or a long time horizon will tend to have more stock in their portfolio's allocation. Conversely, investors with a conservative risk tolerance and/or a short time horizon will tend to have more bonds in their portfolio's allocation.

Asset allocation is an important component of a financial plan because it helps structure a portfolio in a manner that doesn't expose investors to more risk than they are

willing to tolerate. In other words, it spreads the risk across multiple asset classes. An investor whose funds are all invested in small cap U.S. stocks (which tend to be high-risk and volatile) will face more risk than an investor whose funds are spread across multiple asset classes.

Asset Location

Asset location refers to the types of accounts in which assets are held, such as taxable, tax-deferred, or tax-free accounts. Strategic asset location helps manage taxes generated from investments. Municipal bonds are most suitably placed in a taxable account because they do not generate taxable income for the account holder. Taxable bonds are most suitable in tax-deferred or tax-free accounts because the income they generate will not be added to the owner's taxable income in the year earned.

Stocks held long-term are suitable to hold in any account type: in taxable accounts, they receive the benefits of long-term capital gains treatment; in tax-deferred accounts, they grow tax-deferred; and in tax-free accounts, they grow tax-free. Stocks held short-term are most suitably placed in tax-deferred or tax-free accounts, as the owner will not owe taxes on each sale.

Health Savings Accounts

Health Savings Accounts (HSAs) are available to individuals or families enrolled in a high-deductible health insurance plan. HSAs with balances over $1,000 can be invested so that assets can grow by utilizing a long-term investment strategy. These accounts are also triple tax-preferred: contributions are pre-tax, earnings are tax-free, and qualified withdrawals are tax-free as well. The investable assets and tax-preferred nature make HSAs a sound addition to any financial plan, plus they can be used to pay for medical expenses in retirement, which helps preserve assets in retirement and brokerage accounts.

Insurance Planning

Insurance is another key component of a financial plan because it helps protect against unpredictable events. Health insurance assists with paying for illnesses and injuries sustained by the insured. Property and casualty insurance protects physical property (homes, cars, boats, etc.) and can be used to repair or replace the property. Umbrella insurance provides additional liability protection over and above what is provided in property and casualty insurance policies. Life insurance provides a payout at death, which can be used to pay off debts or provide an inheritance to survivors. Disability insurance is designed to replace income when the insured is injured or ill and unable to work. Long-term care insurance can be used to pay for care when a long-term illness prevents the insured from caring for himself or herself. Not all insurance is appropriate for everyone or for every stage of life, so it is important to evaluate insurance needs on an ongoing basis.

Estate Planning

Estate planning can incorporate many different legal strategies. Components that all individuals should consider are the establishment of wills, healthcare power of attorney, and legal power of attorney. These components ensure that individuals' assets are handled according to their wishes and that someone they trust can act on their behalf in circumstances when they are unable to communicate or make their own decisions.

Trusts are varied and serve different purposes. Many people never establish a trust, while others set up multiple trusts. Consulting legal counsel is the best way to receive insight into your estate needs and assess the applicability of creating a trust to accomplish your goals.

Summary

As outlined above, developing a sound financial plan involves many components. Prudent individuals draft their financial plans with an understanding that circumstances will change, and the plan will have to change as well. If individuals are drafting their financial plans themselves, they are encouraged to take their time in developing their plan. Alternatively, individuals who want experienced help with part or all of a financial plan should consider gathering input from competent professionals in the finance, insurance, tax, and legal spaces.