

Are You Financially Fit?

By Gail Vaz-Oxlade

People spend a lot of time worrying about what they eat, how much they weigh and how healthy their hearts are. Over the past 55 years, a woman's life expectancy has increased by 17 years. While we are all now living longer and healthier lives, for many people, financial fitness still isn't a reality. Forty-five percent of single women 65 and older still live below the poverty line. And if that isn't frightening enough, many people are doubtful of chances of ever becoming financially fit.

What's the point in talking about financial planning when it's hard enough to make it to the end of the month? Well, a truism of financial planning is, "it's not how much you earn that counts; it's what you keep that's important." Of course, financial fitness is more than just having enough money. It involves looking at your total financial picture and bringing everything into balance.

The five main components of a sound financial plan include:

1. Money management
2. Risk management
3. Retirement planning
4. Investment strategies/tax planning
5. Estate planning

To ensure a balanced and well-rounded financial plan, you should have goals set within each of these five areas. Just as most athletes have specific goals towards which they consistently work, the key to financial fitness is to set reasonable and achievable goals and consistently work towards them. If you haven't given much thought to what you want to achieve or if your goals are vague, it may be time to take the financial fitness test.

At some point you have to think about what you want to achieve personally. You may want to accumulate a specific amount of money, eliminate your mortgage and credit card debt, or pay off a new car before you retire. Weighing each of your goals against the others will help you to see which are the most important. Whenever you set a goal, make it as specific as possible and write it down. With written goals and specific target dates, you can measure how your financial plan is shaping up each year.

Having decided where you want to be, you need to determine where you are now so you can size up the gap. Complete a net worth statement to see just how balanced your finances are and update this statement at least annually. It is your scorecard of how much your efforts are paying off. Next, do a budget so you can see exactly where your money goes each month. Estimate how much you spend monthly, track your expenses for about three months, and revise your budget to reflect your actual expenditures. Don't cop out and say, "Well I had unusually high expenses this month because..." Emergencies always crop up, and part of being financially fit is having a plan for dealing with those nasty little surprises.

Now look at your income relative to your expenses. If your expenses seem too high, you can either cut back on what you're spending or increase your income. Consider a part-time job to boost your earnings on a short term basis. If you have extra space, think about renting a part of your home for extra income or sharing your home to reduce your living expenses.

Having done your warm up exercises — you've written your financial goals down in order of priority, completed a net worth statement and set up a budget — you now have to decide how

much she will have to put aside monthly to meet your goal. If your goal is unrealistic — you simply cannot save \$50,000 over the next five years — adjust your time frame. One rule of financial planning is the longer you have to reach your goal, and the more your money earns during that time, the less you have to set aside each year.

Here are some important things to consider in drawing up your financial fitness plan.

Money Management: Begin by eliminating your consumer debt, such as credit card balances and loans. Often people pay only the minimum required without realizing how much interest costs work against their overall plan. If your monthly credit card balance is on the high end of the average (\$1,200 to \$2,400), and your card charges the typical 17 percent, you're paying \$400 a year in interest. If you have several cards with high balances, consider a consolidation loan to reduce your interest costs. If your card charges a high rate of interest, transfer your balance to lower cost card. If you have only a small amount to work off, put your cards away until the debt is cleared. Once you're debt free, by all means take advantage of the convenience credit cards offer, but keep tight control of them. When you pay off your balance in full every month, you'll receive an interest-free loan from the credit card company for the period between your purchase and your credit card due date. That's smart money management!

If you haven't already done so, establish an emergency fund for large, unforeseen expenses or temporary job loss. Ideally, your emergency fund should be able to support you for three to six months. If someone in your household shares the expenses, consider how long it would take him or her to find another job.

Risk Management: Next you have to prepare for the risks of everyday life. The ones we seem to deal with quite easily are property insurance, car insurance, contents insurance. The risks we tend to overlook are those associated with our economic earning power. If you or your partner were to die or become disabled and unable to work, would your family have the resources to meet their day-to-day needs? It's a tough question to face, but the consequences of not facing it can be even tougher on your family.

Retirement Planning: The federal government is sending very clear signals that government pensions cannot be counted on to provide sufficient, if any, retirement income. Through means testing of pension and age tax credits, and reduction in senior's benefits, the government is saying loudly and clearly "You are responsible for providing for yourself." Thankfully, we still have Registered Retirement Savings Plans (RRSPs). Any money contributed to an RRSP remains tax-deferred until the funds are withdrawn. And since investments held in RRSPs also grow on a tax-deferred basis, they grow much more quickly than investments held outside an RRSP.

Investment Strategies/Tax Planning: When you buy a fixed income investment such as a guaranteed investment certificate, Canada Savings Bond, money market mutual fund, bond, mortgage-backed security or treasury bill, you will receive a fixed rate of interest. When you buy equity investments — an equity mutual fund or individual stock — you do not receive any guarantee of payment, but you may share in the profits of the company whose shares you bought in two ways. First, you may receive dividend income which is paid from the profits earned by the company. Second, when you decide to sell your shares, if you do so at a profit, you'll realize a capital gain. Both dividends and capital gains receive special tax treatment.

So, why would you choose an equity investment when, with a fixed-income investment you are guaranteed a fixed rate of return on your investment. Why would you choose the uncertainty of equity ownership over the certainty of interest payments? There are two good reasons. First, historically, the rate of return paid on equity investments has exceeded the rate of interest paid on fixed-income investments. So, over the long term (10 years or more), you can expect your money to earn a higher rate of return on equity investments. Second, since dividend and capital gains

receive preferred tax treatment, you will be able to keep a greater portion of the return you earn on equity investments. (Note, this special tax treatment does not apply to investments held in RRSPs and RRIFs.)

Estate Planning: Despite the fact that almost everyone should have a will and a power of attorney, many people don't. Some think their wishes will be carried out by a family member or that they do not have enough money to justify the cost of making a will. Others avoid making a will because their personal circumstances — marriages, divorces, and accumulated children and stepchildren — just seem too complex to unravel. However, if you die without a will, trying to figure out who gets what, and when, can be a mess. And your estate may end up paying more in fees and taxes than it should, leaving less for your loved ones.

If you are married, have your wills drawn up together so that they reflect an integrated estate plan. Review and update your will every three or four years, especially when family circumstances change (weddings, divorces, births, and deaths all result in changes in family structure), your financial circumstances change, new legislation is implemented, or you change your province or country of residence.

Once you're well on your way to financial fitness, don't forget to do an annual review to check your progress and to update your goals. Having taken control, you'll have a better understanding of your financial situation and will be able to achieve the things you want. You can be confident in the knowledge that you're self-reliant. You won't have to depend on anyone now or in the future.

Of course, financial fitness isn't achieved overnight. It takes time, a sound plan, a strong commitment and, perhaps, a financial coach. If you are serious about taking control of your finances and about your independence, you too can get on track to financial fitness. Most of all, it takes a belief in yourself and in your own ability to take charge. See you in the winner's circle.

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About Gail Vaz-Oxlade

Gail Vaz-Oxlade has written ten books on personal finance, written hundreds of articles for the financial media, published a financial magazine for women (FinancialXPress), hosted and co-produced a prime-time personal financial television show (Your Money on TVO), and worked with Canada's leading financial services companies to help educate employees and clients.