

Creating and Following a Real Financial Plan

An Interview With Carl Richards, CFP

Article Highlights

- A real financial plan not only lists your goals, but why they are important to you.
- The best place to start when creating a financial plan is to ask why money is important, because the answers create a framework for future decisions.
- Establishing specified, automatic behaviors will help a person get closer to reaching his or her goals.

Carl Richards is a certified financial planner, director of investor education for the BAM Alliance, and creator of the weekly Sketch Guy column at The New York Times. We recently spoke about the benefits of having an easy-to-follow financial plan.

—Charles Rotblut

Charles Rotblut: *Could you explain what a financial plan should be? I think most people have a conceptual idea of what a financial plan is, but may not be able to correctly explain what should be in it.*

Carl Richards: This is part of the issue I was trying to address in my book [*“The One-Page Financial Plan”* (Portfolio, 2015)]. It was just maybe a subtle shift—I don’t know that it’s a revolutionary shift—just a subtle shift in the way we think when we hear that word. Even as you asked that question, I felt myself tense up a little bit thinking about a two-inch-thick book with lots of assumptions. I don’t know if they work, or if they are going to sit on a shelf and collect dust. In fact, I’ve learned that on an airplane if I want quiet and my seatmate asks me what I do for a living, all I have to do is say “financial planner” and they leave me alone.

What a real financial plan is is pretty simple. It’s a pretty clear definition of where you are today. And I like to call it your current reality. It’s factual. You could think of this as if you’re going on a trip. You start mapping out your trip with where you’re leaving from, where you are today. Then you make a series of guesses about where you think you want to go. You wouldn’t actually leave on a trip until you decided where the destination was. Finally, it’s an effort to map out



how you’re going to get there. It’s pretty simple.

Getting clear about where you are today is called a personal balance sheet, which is just a list of your assets and your liabilities. Once you have this, you can make some guesses about where you want to go.

One of the really important parts of a financial plan that’s totally overlooked and almost never talked about is why you even want to go there. Why are you doing these things? I

like to think of these as a statement of values. You get clear about your values, you make some guesses about where you want to go and you clearly define where you are. Then, it’s the next two or three things that you need to do in order to get yourself a couple of steps closer to that destination. We don’t need to worry about a list of a hundred things, because then nothing gets done. But what are the two or three simple things you need to do in order to get yourself close to that destination?

The last step is repeat, because it is a process. When you complete those two or three steps, you say, “Okay, what should I do next to get myself close to that destination? Is that still the destination I want to hit?” Maybe that part of the repeat might be “Hey, you know what? I think those guesses I made about my goals have changed a little bit.” You just sort of keep repeating that process over and over and over and get committed to the process, not the actual “plan.” That, to me, is what financial planning is.

Rotblut: *In your book, you wrote about asking people why they*

thought money, or having a certain amount of money, was important. Could you elaborate?

Richards: This is my favorite place to start. You start with an exploration of values and my favorite question around that is “Why?” The question I like to start with is “Why is money important to you?” I’m not looking for “to send my kids to college” necessarily, I’m looking for values. Often you’ll hear people say things like “freedom” or “security” or “flexibility.” As they explore it more, I’ll ask “Why is freedom important to you?” The clients may respond with something like “Well, money gives us time.” “Okay, that’s great. Tell me why time is important to you.” Then they may get to something a little closer to the heart, like “Well, we really want to serve in our community and spend time with our family. That’s the most important thing.”

This conversation leads to the point where we can say, “Is that the MOST important thing about money: The freedom so you can have the time to spend with your family and serve in the community?” “Yes.” “Is there ANYTHING more important about money?” “No.” Okay, well, that’s a beautiful framework and it allows us to make these other important decisions.

It’s like when it’s time to renew the lease on your Toyota Corolla and you’re thinking about getting a Lexus. If you have that framework in mind, you can ask, “Hey, is driving the Lexus more important than having the time to spend with my family, if I’ve got to make that trade-off?” Most of us have to make a concession. The answer might be, “A lower lease payment allows me a little bit more flexibility to spend time with my family—that’s what I said was important to me—okay, that decision’s pretty easy now, because I’ve got this framework.”

Rotblut: Do you think having these goals will prevent behavioral errors by helping people frame money within the context of what they really want to do?

Richards: First of all, I don’t know if having defined goals will help solve behavioral mistakes, because to

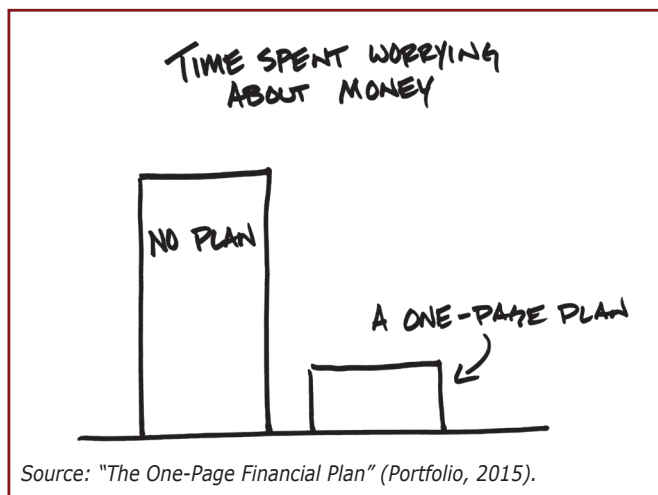
some degree, those are hard-wired. But, here’s what I have seen. We spend so much time arguing. In fact the whole financial industry—I like to call it the financial circus—is focused on arguing over whether we should take a plane, a train, an automobile or a bike on a trip before we’ve even decided where we’re going, to stick with the travel metaphor. The whole industry’s arguing over “No, the train’s better. No, the bike’s better. No, the...” Well, wait a second, where are you going?

I think we’ve been running around, to switch the metaphor a little bit, we’ve been running around taking prescriptions from random people on the street and walking in and filling them without ever taking the time to either get diagnosed or diagnose ourselves. The goal of asking “why are you doing this?” is to diagnose.

Imagine walking out of your office and running into a person who has on a white coat. They hand you a scrap of paper that looks just like a prescription. You can’t read it, of course, but you take it to the pharmacy and a bunch of other people with scary white coats fill it and make you sign a form that says you might die if you take it. Then you take the pills. You would never do this. And yet, often because somebody happens to have a tie and they’re on the financial circus network, we run out and do what they say.

So, all I’m suggesting is that this idea of starting with “why?” is a function of diagnosing and getting clear about where we want to go. When we’re clear about where we want to go, often those behavioral mistakes don’t occur to us anymore. To paraphrase Stephen Covey, “The ‘why’ becomes the deeper yes.” That allows us to say no to all these other distractions: like the new

Figure 1. Having a Financial Plan Reduces Stress



lease on the Lexus, the hot stock you heard about in the news or what your neighbor says to you about investing in this fund. That stuff is sort of like “What?!” It just doesn’t occur to you anymore, because you’re focused, again, on the things you identified when you went through that process.

Rotblut: When you’re working with clients, how do you keep them focused and remembering “This is what I said is important?”

Richards: You remind them. If you’re doing this on your own...well, here’s an example. Right here in my office, I can look up and see “The Richards Family One-Page Financial Plan.” On the very top, it says, “Spend time with our kids, mainly outside, and serve in our community.”

I can also give you a recent real-world experience. A friend of mine came to me and told me about an investment opportunity. It was a private investment. It was amazing. I was one of three people who were invited. All the normal stuff would have sent me into a three-week rathole—doing the research and getting spreadsheets, talking to people and analyzing everything I could to decide if I should invest. This time, I looked up, saw my one-page plan and said to myself, “Wait a second, that doesn’t have anything to do with what I said was my ‘Why.’” So, the answer to your question is we just need to either remind ourselves or have somebody in charge

of reminding us of what we said was important when we were thinking clearly.

Rotblut: *What if someone has goals in mind, but there's a mismatch between what they have saved or what they can realistically save and what they want?*

Richards: Welcome to being human. For most of us, we have an unlimited list of wants or needs and a limited set of resources. In financial planning, the process of making good decisions about money becomes all about that trade-off. We can look at that thing that we say we want or we've called a goal and say to ourselves "Alright, given that I want that goal..." By doing so, we remind ourselves real quickly about what we said was MOST important to us.

The point here is: Let's do it with awareness, instead of subconsciously just buying the stuff and then later going, "Oh, geez, I did it again."

Rotblut: *What if someone's retired? Does that change things?*

Richards: Well, no, the process is the same. We paint these as options to consider. Sometimes we forget that some people have no options.

It's not a whole different discussion. It's just that we get really clear about reality: Even though we're retired, we really wish we had a little bit of extra money to take one trip a year. We can then think about whether there is a part-time

job we could get. Ask, "What do I have control over that I could change?" If the answer's nothing, we need to learn to let go of that. Because if you have no ability to change it, what good—and I know it's easier said than done—is it going to do to worry? So we get sort of clear about these things.

At least there's a framework for learning to let go of the stuff that you can't control and make really clear decisions about your trade-off when you do have options.

Rotblut: *Once a person is clear about his or her goals, should he or she think about how strict those steps should be?*

Richards: The hard work in the beginning is getting really clear, sometimes painfully clear, about your current reality, and having that discussion about the why—your values—then making some guesses about where you want to go. Once that work is done, the art of financial planning is embracing uncertainty.

I know we all wish, and some financial planners pretend, that you can draw a straight line between where you are today and where you want to go. Life never works in a straight line. So, there's an element of this where you've got to embrace uncertainty, which is why I call goals "guesses," because they're going to change. So, you embrace uncertainty and then I think once you've done all

that, in answer to your question, I think you just ask yourself, "What is to be done next? What's the next thing I could do to get myself closer, to sort of head down that path? What's to be done now?" I love that question. "What is to be done now?" You listen carefully to what shows up, you do it and you just keep repeating that process.

I just had somebody in the office, who, two days before, sent me a text at 6:00 a.m. saying, "I've been thinking about this all night and I woke up in the middle of the night realizing that I really needed to get my retirement plan set up. Can I come in and have you help me with it?" He came in and we set his plan up at Vanguard.

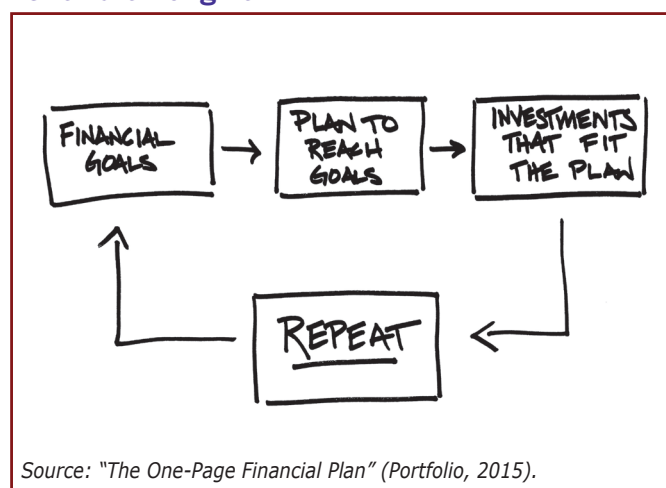
All I'm saying is I think those things show up. Maybe it's like, "I've been thinking forever that we really need to get life insurance in place." Okay, get the life insurance in place. "Oh, I've been thinking forever that we need to start saving money for the kids' education." Okay, can you find an extra \$50, an extra \$100 a month? Go get it figured out. Take the time to figure out where the right place to set that money aside is, get it set up as an automatic withdrawal out of your checking account and do it. Then, it's done and maybe you get a little space, a little rest. Then the next thing shows up and you do it.

Rotblut: *For somebody reading this and wanting specifics, you're saying, figure out what your goals are first and then what you can realistically do, versus worrying about having a checklist of a, b and c steps?*

Richards: Yes. I wish we could draw this straight line between where you are today and where you want to go, and then tell you "Do these 18 things and you'll be there." But that's called fantasy. Reality is: "I've identified some goals. One of my values is my kids and I want to make sure they have money for education." Just to use that as an example. One of my other values is, sort of, freedom at some point in the future. I want to save for retirement.

Okay, let's get really specific: What can I do today? I think I could find \$50 for each of my kids to save. I can set up a 529 account in the Utah Plan (which is where I happen to live), and I can have the money pulled from my checking account on the 15th of every month. That's very specific, it's got a deadline, it's going to happen, it is automated—it's everything everybody says you should do. But the problem is, should that be YOUR goal? I have no idea.

Figure 2. Adhering to a Process Is Important Over the Long Term



So, yes, I think you back out from the values—where you are today, your goals—you back into very specific automated behaviors that will get you closer. Now, I may wake up in a couple of months and say, “I think we should switch that \$200 a month toward paying down our mortgage, because we really want to get out of debt as fast as we can.” Okay, then, I’ll switch it. But, again, define very specific actions and, to the degree possible, automate the behavior, because if we don’t automate it, we all know what will happen. It will never happen.

Rotblut: *What about allocation? If someone has goals with different timelines, should they be thinking more in terms of a bucket strategy, where they’re considering when they’ll need the money to accomplish certain goals?*

Richards: Normally that’s the right way to do it.

I’ve been doing an experiment lately. I ask, “Why is your money invested the way it’s invested?” I get answers like “Well, because I read about it in a magazine, I heard that clown on the financial circus network yell about it, or my neighbor talked about it.” But do you own them because these investments work together, complement one another?

Allocation is not a smorgasbord of investments; each one is carefully picked to give a person the greatest likelihood of meeting his or her goals. Most of the time, that’s linked to some time frame. Right? That’s easy. We can take on the risk question, but the easy answer is yes, it’s linked to some time frame.

But your investments should be there for a purpose, and the purpose should be to meet your goals. That’s why everybody’s investment portfolio is, to some degree, tailor-made for them. At least it should be.

Rotblut: *In your book, you also discussed a situation where you asked a colleague for a quick financial plan, insisting that you only had a few minutes to talk and just wanted to know what to do. He responded by saying he couldn’t give a quick answer. I think there is a disconnect between investors who just want simple instructions and don’t realize, from the standpoint of an adviser, that there aren’t simple instructions to give.*

Richards: I think that’s because real financial advisers are so focused on customizing a tailor-made plan, in other words, the “best” plan for each client. But, the dilemma, of course, is if you’re not one of their clients and you have to make these decisions on your own, you’re just looking for some guidance. Sometimes this pursuit of “the best” gets in the way of doing anything at all.

If all you did was say, “Hey, I don’t need this money for 10 years and I’ll put it in the S&P 500 index, and everything I need in less than 10 years, I’ll buy CDs.” If that’s all you did, and then you got to work figuring out how to save a little bit more each month—figuring out how to make a little bit more money at your job or start a side-hustle, as people call it, so you can save a little bit more—saving a little bit on your taxes, making smart decisions about your spending...you would be better off than 99% of your neighbors. Because they’re just busy running around trying to find the best investment in the world, and we all know that behavior, that well-intentioned behavior, often leads to disastrous results.

Rotblut: *Finally, since you emphasize the point of simply behaving correctly for a really long time, could you give some basic suggestions on how people can accomplish this?*

Richards: I think we just need to let go of this myth that finding the best investment is the job of investors. That’s not the job of investors. The data is super clear about this. If you

just own a mediocre investment, but behave correctly for a long time, you will be ahead of many other investors. Another way to put this is, if you find the best investment, but get scared out of it at the wrong time, you just blew up all that work.

The investment process only matters to the degree that it influences behavior. So, the best investment for you is the one you can hold on to for a long, long time. And, I see this all the time, because I hear people say things like, “My house is the best investment I ever made.” We’ll go back through the records with them—I’ve done this a couple of times, just because it’s kind of interesting—and we’ll see what their average rate of return has been. What would you guess the average rate of return has been?

Rotblut: *Probably inflation, if that.*

Richards: Yes, it’s about inflation, 2.5% or 3%. Over that same time period, the equity markets did close to 10%, so let’s just call it 8% even. How in the world was their house their best investment? Well, because it was the only investment that they behaved correctly with.

So, figure out how to just not get too concerned with what your investment is doing now, and think of it as an oak tree and leave it alone. I love Warren Buffett’s idea: Who would plant a tree and dig it up every quarter to see how the roots are doing? Just leave it alone.

That means ignoring an awful lot of noise. It means ignoring what your neighbors are doing. It means ignoring this whole giant complex that we almost think of as the financial services industry. It’s all built up on this circus that there’s something that you should be doing. The reality is you get paid incredibly well for doing absolutely nothing. Right? For being lazy. That’s amazing. Why not take advantage of it? ▲

Carl Richards, CFP, is director of investor education for the BAM Alliance and creator of the weekly Sketch Guy column at The New York Times. Richards will give a keynote address at the AAIL Investor Conference this fall; go to www.aail.com/conference for details. Find out more about Richards at www.aail.com/authors/carl-richards. Charles Rotblut is a vice president at AAIL and editor of the AAIL Journal. Follow him on Twitter at twitter.com/CharlesRAAIL.