MULBERRY BOW

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Achieving Financial Freedom; Two Clients Who Took Very Different Paths

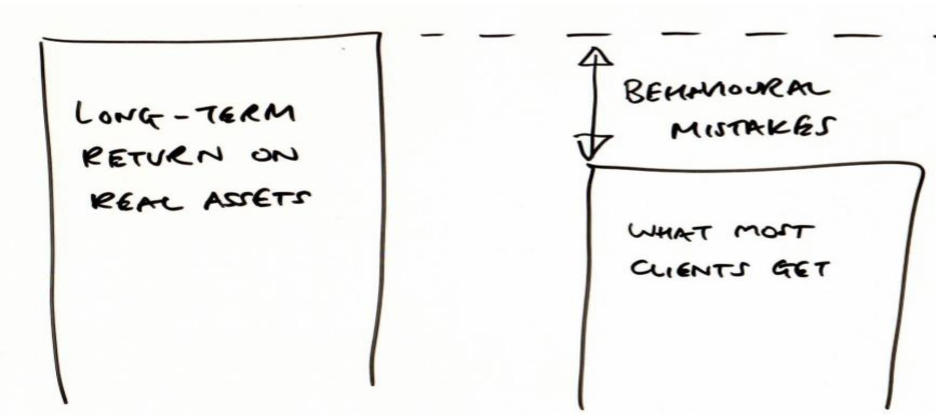
What we do at Mulberry Bow is often 'theoretical', and when one considers planning concepts over a short timeframe it can be difficult to see the impact. In this Bow Blog, I'd like to bring to life one area of planning to demonstrate just how impactful it can be, by considering two clients who have taken very different paths.

One of the (many) unhelpful ideas when it comes to money the 'medium-term' time horizon. There's a lot of talk of '*at least five years'* and I've had healthy clients over 60 say things like *"I can only plan for the next three years because anything could happen*". It's hard to argue with the second half of that statement, but how helpful is it as the basis for a strategic plan? The average life expectancy of an 80-year old in the UK is around seven years and I would suggest that anyone under 70 should be planning for at least 15 years and I want to explain why that is very important.

Managing Uncertainty Not Removing It

Planning for the next 20 years does not mean you think you remove all uncertainty or that you are shaping your Plan in the belief that you will never need to finetune it. The opposite is true, you think in terms of 20 years precisely because good financial planning is a *process not an event*. Revisiting the Plan semi-annually or quarterly is vital to it delivering the peace of mind that is ultimately the goal of all planning. One must also accept that your Plan is based on guesses: future investment returns, tax rates and income needs etc. but there's lot of open water between no Plan/blind faith and a thoughtful Plan with calculated guesses.

Consider Financial Freedom. If you feel 3% net p.a. is a reasonable 'drawdown', in the hope of retaining capital, you need c.£7m to feel comfortable taking £200k p.a. If you can live well on that, £7m is your 'Lifestyle Number' and achieving it means you only work if, when & how you wish (or you don't, you sit on a beach or go sailing instead!)



We Can Do This the Easy Way or the Hard Way

The thing is, there is a big gap between the long-term return on real assets (shares, property etc.) that tend to be the best way of achieving that Lifestyle Number and what most investors actually achieve. Let's consider two clients (both based on real cases I've seen) with the same Lifestyle Number to discover why that might be.

First, 'James'. We only started working with him recently, after he had already reached £7m, through a combination of saving diligently for 20 years and the recent sale of his business. He thought about a Financial Plan after selling the business, so he only had £110k in ISAs and £120k in pensions ("*I've been too busy making the money to think about what to do with it*"). On average, over those 20 years, about half the money had sat in cash, with the other half invested in randomly selected funds and shares, plus one buy-to-let (with no borrowing). James had been enjoying a return of around 4% p.a. and paid an average tax rate of roughly 30% on returns. His average net return had been c.**2.8% p.a.**

Let's now consider a different client I came across about 10 years ago, 'Sarah'. When we met, Sarah and her husband were 40-something and had a financial adviser, a local chap who had done a decent job for them, but whom they felt they had 'out-grown'. They were a bit earlier in the 20-year journey than James, but Sarah's business had become very profitable and her husband had recently 'taken the silk' and become a QC. They'd consistently funded ISAs and pensions, and borrowing had enabled them to buy several buy-to-lets. We added additional layers of tax-efficiency, including an offshore insurance bond, a program of investment into EISs/VCTs and using children's tax-free allowances.

Sarah & her husband recently reached a similar Lifestyle Number to James, but when I (roughly, I admit) worked out their average annual return it was c.8%, the kind of return most 'medium-risk' investors *should* have enjoyed over most 10-year periods in modern times. Just as importantly, they hadn't given a third of that return away in tax; they'd used all allowances, plus legitimate tax deferral/control, and kept their tax drag down to c.10%, 'netting' **c.7.2% p.a.**

Please note the figures in this blog are approximations to explain a planning point and are not exact, it's also important to note that they should not be viewed as a guide to future performance of investments. Similarly, the case studies shared are based on real examples, but the names and some details have been changed to preserve anonymity.

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Turning on the Tap

There were two striking things when I compared James's situation to Sarah's. The first was that Sarah's business proceeds were topped up with £2.7m saved in just over 8 years; it took James 20 years to save the same figure. Because Sarah got a similar figure to for her business as James's, this meant she reached financial freedom over **11 years earlier**.

The other striking thing was Sarah and her husband's options in terms of drawing down income and shaping their Estate Plan. With £2.5m in pensions (IHT exempt), £1.2m in ISAs (offering tax-free income), an offshore insurance bond (5% p.a. tax deferred allowance, with 8 years 'unused') and a large portfolio of 'self-funding' EISs/VCTs (tax-free dividends and income tax relief), we were able to generate their £200k p.a. net income with only £8k of tax (which the EISs mop up). It was also easier to mitigate inheritance tax. The income planning and Estate Plan for James will improve with time, but it's proving more challenging, because we're virtually starting from scratch.

Conclusion

It's often said that the impact of technological change is overestimated in the short-term and underestimated in the long-term, and it's clear to me that the impact of a coherent Financial Plan is similar. It's also one of those areas in life where whenever someone asks "*When should I start"* the right answer is always "*Now!".* We hope you found this Bow Blog helpful. We are working on a new financial education project, MBMA, more of that soon.

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Independent	Clear & Concise	Responsive	Transparent advice fees
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Technically sophisticated	Semi-annual reviews	Stability & continuity	Demonstrable value

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