Your financial life

Understanding the stages of the financial lifecycle

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Ideally, business owners would take a comprehensive approach to managing their wealth over their entire financial lifecycle — a lifecycle that aligns closely with that of their business, a significant source of wealth generation. However, most don't.

"Business owners are often so focused on growing their business that they don't pay enough attention to putting together a personal financial plan to manage and protect their wealth," says Robert Klug, senior vice president and regional manager for Western Pennsylvania and the Ohio Valley at Huntington Private Bank.

Smart Business spoke with Klug about wealth management for business owners.

What are the stages of an individual's financial lifecycle?

There are four stages to an individual's financial lifecycle. There is the accumulation of wealth, growing or managing wealth, preserving and protecting wealth, and transferring wealth. Each phase of the cycle overlaps and needs to be managed using a comprehensive approach.

For business owners in the earlier stages of their company, often all of their wealth is tied up in their business. As the business grows and helps the owner accumulate wealth, the owner has to transition into managing that wealth — a critical stage of the financial lifecycle because those who don't manage their wealth well will have nothing to work with in the subsequent stages.

As individuals move into the preserve and protect stage, the decision comes down to risk. A reduction of risk typically means stepping back their potential returns in exchange for less volatility and a portfolio that stays just ahead of inflation. It's also thinking about how to complement their portfolio with life insurance, and how to offset their health care costs or pay down debt.

The last phase is really about making sure the accumulated and preserved assets go to the people the individual intends them to go to. It means having a sound estate plan to transfer wealth.

What are the keys to successful wealth management?

Primarily, business owners should have a sound financial plan that's dynamic — it changes as they move through their financial lifecycle to make sure it's in alignment with their changing goals. Ideally, it also involves a trusted team of advisers that include a tax professional, attorney and a wealth management professional, the latter of which should be capable of coordinating the efforts of the entire team.

The other major aspect is managing risk because risk determines return — the greater the risk the greater the potential return, but it also increases the chance of a downside return. Just like a business owner manages risk in his or her company, it's critical to manage risk in an investment portfolio.

One way to manage risk is by using an asset allocation strategy to divide the wealth among the three major assets classes: cash, bonds and stock. There are specialty assets — alternative investments, hedge funds, commodities — that can complement a wealth management strategy.

How do individuals commonly derail their wealth management efforts?

Beyond simply not taking the time to plan, another way they derail their efforts is to overreact to market volatility. Sometimes investors sell off everything in their portfolio at the first sign of trouble and miss the next run-up.

Portfolio management requires a sound asset allocation strategy. They're best served if they stick to their plan, one built to account for their risk tolerance, from the beginning. People get themselves into the most trouble by not understanding their risk tolerance and abandoning their plan far too early.

Wealth management means taking into consideration a person's entire financial livelihood. It's not just deposits and lending, their business or how much they have invested in the market. It's putting all of it together and developing a plan so they can grow, preserve and transfer wealth. That requires a plan assembled with trusted advisers that is dynamic enough that it can change over time. It means understanding personal risk tolerance and managing through risk. ●