

The

A—Z

of financial planning

*The smart investor's dictionary by*

**RJM Financial Management**

# WELCOME

Welcome to the A-Z of financial planning, a dictionary crafted to help you develop a comprehensive understanding of essential financial concepts and principles.

This dictionary emphasises the importance of adopting a long-term perspective, recognising that smart planning transcends fleeting market trends and short-term opportunities.

My goal is to equip investors with the knowledge and insight necessary to make informed decisions that will lay the groundwork for lasting financial success.

Sincerely,

**ROBERT JOHN MCFARLANE**

## Asset Allocation

*Asset allocation is the process of distributing a portfolio among various asset classes, such as equities (the great companies of the world), property, cash, and bonds (lending to governments and companies). This crucial decision significantly influences future investment returns. Using history as a guide, we know that equities provide superior returns over the long term.*

## Bonds

*Bonds, an asset class permitting investors to lend money to governments or corporations, usually provide a more stable investment return. This stability, however, comes at the expense of long-term returns. Investors should carefully consider this trade-off between 'safety' and potential long-term growth before committing a large allocation of their funds to bonds.*

## Compounding

*Compounding, hailed as the eighth wonder of the world, is the process of earning returns on prior returns. The human mind tends to grasp linear returns more easily, yet the investment world offers compounding returns for those who invest with discipline and patience over an extended period. Ultimately, it is this compounding effect that paves the way for long-term financial independence.*

## Diversification

*Diversification is the practice of allocating your money across multiple securities within an asset class. This approach enables investors to minimise their downside risk by avoiding overexposure to any single asset. While diversification may prevent one from making a fortune in the short term, it also safeguards against potentially devastating losses.*

## Estate Planning

*Estate planning is a vital process for investors seeking to safeguard their assets for future generations. It involves structuring an investor's finances in a sensible manner that ensures the seamless, cost-effective distribution of assets according to their wishes.*

## Fear

*The emotion most responsible for investor mistakes. In the good times, investors fall prey to the fear of missing out (FOMO). This leads to overconfidence and a tendency to allocate excessive funds into a single asset, 'going all in'. During market downturns, the fear of capital loss prompts investors to make short-term decisions that often result in long-term losses.*

## Growth assets

*Growth assets provide investors with a rising income and increasing capital value. In contrast to income assets that solely generate revenue without capital growth, these investments serve as an effective shield against the destructive force of inflation.*

## History

*The future is always uncertain. However, by using history as a guide, we can learn fundamental truths about the investment markets. Being guided by these truths helps us to make smart investment decisions based on past cycles.*

## Inflation

*Inflation refers to the slow but steady increase in the price of goods and services. It destroys the purchasing power of our money, which is the only sane definition of wealth. The investor's primary aim should be to combat this destructive force. Smart investors understand how different asset classes help them to combat inflation.*

## Jargon

*The world of financial services is rife with complex jargon, often designed to intentionally bewilder investors. Sensible financial planning need not involve an extensive list of technical terms; its primary objective should always be to help you understand your financial position and how it can provide for your future.*

## Knowledge

*Building a solid foundation of knowledge about stock market history, asset classes, and behavioural biases is a crucial element of making informed investment decisions that align with an investor's long-term financial goals.*

## Longevity

*The modern phenomenon of people living longer is one of the biggest factors that should drive your personal financial planning. Understanding how your wealth can provide a sustainable income for the rest of your life is the primary aim of good financial planning.*

## Media

*The financial media is a dangerous influence on the minds of investors. Driven by advertising revenue and viewership, the media's goals stand in opposition to the patience, discipline, and optimism required for effective long-term planning.*

## Net worth

*Although a crude measure of wealth, net worth refers to the total assets of an investor, less their liabilities. It is this number that the smart investor works to increase during their saving stage so that it can provide for their lifestyle during their spending (retirement) stage of life.*

## Optimism

*Optimism, a prevailing trait among successful long-term investors, embodies a positive outlook on life despite the inundation of negative news and short-term crises. This optimistic perspective enables investors to make decisions that capitalise on the ongoing human progress observed historically, which we anticipate will persist in the future.*

## Patience

*Patience is a vital trait shared by successful long-term investors. It describes the ability to remain focused on long-term results while at the same time acknowledging the inevitable short-term uncertainties.*

## Quarterly report

*One of the most harmful practices in financial services is the requirement by investment providers to send quarterly reports to all investors. This has the tendency to tempt investors into making short-term decisions when they would be better off ignoring the temporary fluctuations in the value of their investment portfolios. In investing, the less you do, usually the better the results.*

## Retirement

*Retirement refers to the 'spending stage' of one's life cycle. This can be contrasted with the saving stage, during which investors are accumulating assets. It is during retirement that investors start drawing from their capital in order to provide for their cherished hopes and dreams.*

## Savings

*Savings, unlike long-term investments, serve as a safety net for short-term expenses and life transitions. Astute investors often keep this capital in secure accounts, sheltered from the volatility of investment markets.*

## Total return

*A measure of return that includes both the income yield and capital growth of an asset. This is the return that smart investors focus on. Inexperienced investors have a tendency to focus on the income yield only.*

## Units

*Investment units are the underlying currency of an investment portfolio. A smart investor understands that during times of temporary market declines, their same contribution amount enables them to buy more investment units. This is the ultimate path to long-term investment success.*

## Volatility

*Volatility refers to the short-term fluctuation in asset prices. It is often confused for a measure of risk. In reality, volatility is the price for long-term financial security and should not be avoided when making long-term investment decisions.*

## Wealth

*Wealth is the accumulation of productive assets. It offers financial security, freedom, and independence to those who proactively plan their finances. This powerful force benefits not only investors but also their future generations. Wealth should flow like a river through the generations.*

## Index

*A brilliant innovation of the modern financial system, an index enables investors to diversify among various assets in a simple manner. The investor earns market returns with minimal decision-making and can devote their attention to managing their overall strategy and behaviour.*

## Yield

*The primary concern of short-term and conservative investors is investment yield. This differs from an asset's total return, which encompasses both the growth in capital value and the yield itself.*

## Zero

*The primary goal for retirees is to prevent their net worth from reaching zero. Two types of retirees exist; those who outlive their money and the savvy investors whose wealth outlasts them. You want to be in the latter group.*

### **Need Advice?**

*Helping families on their journey to financial success is our reason for being. If you have expensive money questions that you need answered, get in touch to find out more about our financial planning process.*