

MAKING CENTS PLANNING FOR FINANCIAL INDEPENDENCE

-John P. Napolitano, CFP®, CPA, PFS, MST, RLP®



Financial independence means different things to different people. For some, it means getting past living from paycheck to paycheck. For others, it means being debt-free. But for my clients, it means that they've saved enough to live their desired lifestyle without having to work every day.

To answer the quantitative questions about financial independence, there are a bunch of assumptions and variables that you need to address. These assumptions include your target date for financial independence, your living expenses in today's dollars, an assumed inflation rate, an assumed rate of return on your savings and investments, how much you can add to savings and investments between now and independence, and your life expectancy. As you can see, there are very few of these variables that you can nail down and guarantee, but let's see how you can use your best estimates to help plan your independence.

First you need a good handle on today's living expenses. Start by looking at your last three to six months worth of bank statements and see what the average outflow is on a monthly basis. If you use cash, either start taking traceable ATM withdrawals before you spend the cash or keep a journal of your cash expenditures. Now reduce that amount for expenses that you won't have in the future and add to it for expenses that you'd like to have in the

future. During this process, also figure out how much you can afford to sock away each month. Unless you are already financially independent, you probably need to get a regular savings program going.

From here, choose an inflation rate. It's easy to simply select the published consumer price index as your inflation rate, but there is a theory among

financial scholars that certain expenses frequently rise faster than the CPI - such as fuel and medical costs. So to be safe, I'd suggest using a rate of inflation higher than the published increases in the CPI.

Now estimate the rate of return on your savings and investments. Because this is such a

moving target, you need to be very careful with this part. A small change in the actual rate versus the assumed rate can have a dramatic impact on the outcome. Interest rates, stock markets and real estate values are always in flux, and for that reason, this variable needs to be revisited regularly.

The ultimate variable here is life expectancy. How long will you need to support your lifestyle, and will those needs change based on age and health. To be safe, estimate a long life expectancy and plan for contingent expenses associated with your aging.

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