FINANCIAL ACTION PLAN

10 STEPS TO HELP YOU BUILD A BETTER FINANCIAL FUTURE

In these uncertain times, it can help to focus on the things you can control. And working out what your money's doing for you now and where it might come from in the future can give you real peace of mind.

1.
SHOW ME THE MONEY

The first step to getting your finances on track is to know where your money is going. But that isn't always obvious. Tracking your expenses can keep your spending on a parallel track with your income and help you avoid overspending. This goes hand in hand with setting up a budget. You may have a good handle on your monthly bills, but what about your daily expenses? You may be surprised by how much money you spend on smaller items. Review all of your expenses for ways to cut back, and then decide what to do with the extra money. Set specific goals, such as building an emergency savings fund, paying off your credit card bills or increasing your retirement savings.

2.
REDUCING BORROWING

Next make a list of all the borrowing you have – including mortgage, personal loans, store cards, credit cards and bank overdrafts. Calculate the amount you owe and remember that you should update this as the year progresses to track your progress. If you cannot reduce your overall borrowing, then you need to ensure you are paying as low an interest rate as possible. This may mean switching credit cards or mortgages, or consolidating various borrowings into one loan.

3.
TAX REALLY MATTERS

There are plenty of tax allowances to make use of each financial year – remember this runs from 6 April to 5 April the following year – so it's worth being aware of which annual allowances you can benefit from. All tax rates quoted in this article are applicable to the current 2020/21 financial year.

One of the most popular ways to save tax is by fully utilising your individual annual Individual Savings Account (ISA) allowance, which is £20,000. You may save or invest your ISA allowance into one or more different ISAs, or you can put up to £4,000 into a Lifetime ISA (you must be aged 18 or over but under age 40 to open a Lifetime ISA). You won't pay income tax, dividend tax or capital gains tax on the proceeds of any investments you hold within an ISA.

In addition, investors have a £2,000 tax-free dividend allowance held outside of an ISA. Basic-rate taxpayers pay 7.5% on dividends. Higher-rate taxpayers pay 32.5% on dividends. However, if your dividend income is above this amount, investing in an ISA could give you the benefit of additional tax-efficient payments.

If you are a basic-rate taxpayer the Personal Savings Allowance (PSA) permits you to earn up to £1,000 interest on your savings without paying any income tax on it. If you are a higher-rate taxpayer you have a PSA of £500 before you pay tax, while additional-rate taxpayers who earn over £150,000 do not qualify for the PSA. ISAs may remain worthwhile for those additional-rate taxpayers who don't qualify, or who have a large amount of savings and have used up the PSA.

If you have investments held outside a pension or ISA, these will usually be subject to capital gains tax when they are sold or given to someone other than your spouse. The gain is usually calculated as the sale proceeds less purchase cost from assets and is taxable at 10% (basic-rate taxpayers) or 20% (higher and additional-rate taxpayers) except for residential property, where the rates are 18% and 28%.

Everyone has an annual tax-free capital gains allowance, currently £12,300. Gains up to this amount can be realised tax-free. If an asset is held jointly with a spouse, both can use their annual exemption against the gain, effectively doubling the tax-free allowance amount.

However, remember that tax rules can change in the future and their effects depend on your particular circumstances, which can also alter over time.

4.
GOOD INVESTING HABITS

Investing money regularly, instead of as a one-off lump sum, can reduce the impact of a market downturn on your portfolio. If you are looking for a smoother ride during volatile markets, pound-cost averaging – where money is drip-fed into the market over time – may be an appropriate option. Steady, regular investments can provide you with some protection in case of sudden market corrections.

Given that we don't know what markets will do from day to day or month to month, this stops you from investing all of your money at a peak and maximising losses. Some of your money will be invested when markets are down, so when they recover you are rewarded. Over the longer term, investing monthly averages out the highs and lows.

5.
PENSION SAVINGS BOOST

It's important to think about how much money you might need in the future and whether you'll have enough to give you the lifestyle you want. Making the right choices now could make a big difference to how much money you have in the future and saving into a pension plan could help you achieve the lifestyle you would like.

Even if you feel that your savings are on track to live comfortably in retirement, you can still top up your pension plan to help give your savings a boost and increase your potential wealth in retirement.

One of the great things about saving into some pension types is the tax relief you can receive. This means that if you're a basic-rate tax payer, for every £100 saved into your pension the cost to you is only £80. This could effectively be even less if you're a higher or additional-rate tax payer.

Tax rules may be altered in the future, and their effect depends on your personal situation, which can also change. Bear in mind, too, that you can't ordinarily draw benefits from a pension arrangement until you are aged at least 55 (rising to 57 by 2028), so this is a long-term investment.

6.
FOCUS YOUR GOALS

Did you start 2020 with plans to save and invest more money and reduce borrowings, but lost your way? Refocusing your finances and recommitting to financial goals can seem challenging, especially during the coronavirus (COVID-19) pandemic, but it's not a lost cause.

Focus on making several small, short, achievable financial goals. By setting smaller goals and achieving them one at a time, you're more likely to stay motivated and reach them.

Remember, yesterday is done and gone. You cannot change what you did yesterday, whether you made good choices or bad ones. But you can change what happens today. Being clear on your financial goals is essential to making the most of your money. Making decisions with a clear endpoint in mind can make it easier to achieve financial security and independence and allow you to enjoy the life you want.

7.
STICK TO YOUR PLAN

As governments around the world take further action to stem the spread of coronavirus, stock markets continue to react with increased volatility. During any period of volatility, thinking about your reasons for investing and what you ultimately plan to do with your money is important. But market volatility is unavoidable and is part of market behaviour. Markets move through stages of growth, slowing down and speeding up. Unfortunately, the timing of those cycles can be unpredictable.

Selling out in fear can be the worst thing to do. Large falls can often be followed by large rises, leading to the risk of losing on both sides – selling when prices are depressed and not buying in until they have moved higher. Avoid the daily monitoring of investments during falling markets as this can result in an over-emotional reaction and lead to making irrational decisions.

8.
SMOOTH OUT RETURNS

When it comes to investing, you need to take on some risk in order to generate a return. One of the best ways to control that risk is through something called 'diversification'. 'Don't put all your eggs in one basket' is a common expression. This means ensuring that you spread your capital amongst different investments so that you're not reliant upon a single investment for all of your returns.

Different types of investments perform in different ways over time. When some rise in value, others are not changing or decreasing. So diversification helps to smooth out your returns. The key benefit of diversification is that it helps to minimise risk of capital loss to your investment portfolio.

9.
DISCUSS YOUR CONCERNS

When faced with certain choices and in the midst of volatile periods, some people may understandably fall prey to their stock market emotions and make decisions that are not in their best long-term financial interest. But it's natural to feel worried.

Even experienced investors steeped in the market's historical cycles may feel torn between emotions and knowledge. That's why having a professional financial adviser, who can advise you before making any decisions, is key. This will enable you to discuss your concerns to help keep those market emotions in check and work together to ensure your long-term investment strategy remains on track.

10.
REINVEST DIVIDENDS

Dividends are payments of some of the profits made by a company to its shareholders. They are not guaranteed, and are at the discretion of the company, but when they are paid, you have the option to reinvest them into more of that company's shares. Reinvesting dividends provides benefits that shouldn't be ignored.

In a current era of low interest rates, investors need to use every tool they can to make the most of their money. Reinvesting dividends can add significant wealth over normal investment returns and is one of the most powerful tools available for boosting returns over time. Those seemingly small amounts reinvested can grow into much larger amounts when used to buy even more shares of stock that can pay further dividends in turn. ■

BRINGING YOUR FINANCIAL PLANS TO LIFE

Planning for a successful future means different things to different people. Whatever your plans, expert professional financial advice can help bring them to life. As the impact of coronavirus is felt across the UK, you may have concerns about how it could affect you and your money. Please contact us to find out more or discuss your future plans with us.