Financial planning for young professionals

SA's young professionals are money-savvy

The number of young professionals in SA has increased, and one of the reasons for this has been the unprecedented economic boom experienced over the past couple of years. A fair amount of our time as financial planners is spent advising our young professional clients.

We have noticed that these young professionals have become increasingly sophisticated with regard to financial matters.

Different from their parents

Young professionals are different from their parents' generation in that their number one priority is not paying off the mortgage. They tend to diversify their investments away from the family home into shares, unit trusts, commercial property, listed property, structured products and derivatives.

Many of our clients appreciate the value of good advice and are content approaching financial planners, provided the planners have the correct credentials. They understand the link between sound financial advice and wealth creation. They also understand that sound advice is worth paying for.

Protect their income

This group generally recognises the importance of insurance. Recent studies have suggested that most South Africans are heavily under-insured. However, over the past couple of years we have noticed that young professionals, although price sensitive, understand the link between wealth protection and wealth creation. Life, disability and trauma cover are expenses for which they budget. Income protection is especially important to them as they see their income-earning ability as an asset worth insuring.

Potential dangers

Although we see many encouraging trends in our dealings with young professionals, there are still some dangers that need to be kept in check.

- The temptation of easy credit can lead to debt becoming unmanageable. Many financial institutions are eager to extend excessive credit to young professionals. Fortunately, the National Credit Act has

to a large extent ended these practices. It is still worthwhile for young professionals to budget on a monthly and annual basis. Where possible, it can be beneficial to open a low-cost banking account and forego those banking accounts with ‘free’ extras, which are not really necessary. It is also wise to use the interest-free days on credit cards.
- The investment decisions taken with regard to company retirement funds can make a dramatic difference in future. It is important that professionals assess their specific circumstances before making a decision. Most company retirement funds have a default option in cases where no member election is exercised. Most young professionals’ investment time horizon is in excess of 25 to 30 years, so they should choose a more aggressive investment portfolio.
- The temptation to keep up with the latest investment fad can destroy wealth at the click of a mouse. The internet offers one the opportunity to switch investment funds easily at relatively low cost. Morningstar, an American fund-rating service, analysed the return on 219 funds for the period 1989 to 1994. Over this period the average return on these funds was 12,5% per annum. However, when they analysed the actual return of the investors in these funds they found that their return was -2,2%. The actual returns were destroyed by investors trying to switch in and out of funds in an attempt to time the market. We have seen evidence of this many times in our consultations.
- Estate planning is often overlooked by young professionals. Basic estate planning starts with having an up-to-date will and a financial strategy for managing your affairs at your death. It also includes ensuring that you have completed your beneficiary nomination on your company retirement fund. Divorced young professionals need to pay particular attention to this, and a letter of wishes to the trustees of their company retirement funds may be necessary.
- A comprehensive financial strategy can grow and protect wealth. Income tax and capital gains tax consequences need to be taken into account in virtually every transaction as these can significantly reduce returns. A young professional with a higher tax rate and various investments can use the assistance of a financial planner to develop a strategy to maximise opportunities and reduce risks. A good financial planner will also work in tandem with their clients’ accountant, lawyer and stockbroker to ensure that all pieces of your plan fit together.

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