Prime Capital FINANCIAL

HOW DOES FINANCIAL LIQUIDITY IMPACT A WEALTH PLAN?

Financial liquidity allows you the freedom to easily access a designated reserve of money when you need or want it. Financial liquidity means you have access to cash in case 1) there is an emergency, or 2) you want to purchase something, or 3) an unexpected opportunity comes along that you would like to take advantage of.

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In fact, a huge part of financial planning is making sure you're protecting your wealth by having proper liquidity in place as part of your plan. So, let's examine this crucial aspect of financial planning, wealth, and lifestyle protection.

Proper Liquidity Helps Ensure Your Other Assets and Plans Stay In Place

A lack of liquidity can negatively impact your long-term financial plans. For instance, what if you suddenly need a major repair, like your air conditioning or heating goes out? A new HVAC system can cost upwards of $10,000 or more. If you have adequate liquidity, you can handle this expense. If not, you may be dipping into your retirement fund, borrowing money at a high rate, or selling off assets you wanted to keep in order to pay for the repair, all of which can put your long-term plans at risk.

Having liquidity in place for wealth and lifestyle protection involves strategies to help ensure that your financial assets and your standard of living are safeguarded against unforeseen events, including negative events like emergencies, and that the assets you intend to use later in retirement or leave to your heirs stay in your hands.

Liquidity Gives You Flexibility

Nobody wants to be restrained. Nobody wants to have to be forced to sell a property or forced to borrow money at an unfavorable rate or have to work longer because they don't have the flexibility. Nobody wants to sell a stock when the markets are down. None of us wants forced selling.

Protection against unforeseen adverse life events is one part of why liquidity is important. But the other part of liquidity is having funds available so that you don't miss out on opportunities. Maybe that dream home you always wanted suddenly becomes available. Or there is an investment opportunity that arises that really makes sense in terms of your risk tolerance and overall portfolio strategy. Or maybe you want to purchase a car for your child's 16th birthday.

In other words, financial flexibility can provide financial freedom in addition to protection.

Emergency Fund: What Is the Right Amount?

Generally speaking, most financial advisors will say you should have three to six months' worth of expenses in liquid accounts for emergencies. But you really need to think about your own personal situation.

If you're single and you have no children, three months of expenses might be enough. If you are married and you have children, you may want to have closer to six months. You should also think about the job that you have. If you have variability in your income—for instance, if you are in real estate or an industry with cyclical ups and downs—you may want to go even higher than six months, potentially nine to 12 months.

However, rather than using a rule-of-thumb formula based on income, you may want to take a pen and paper and write down your actual expenses rather than basing your emergency fund amount on your income.

Don't forget contingency planning and potential expense exposure either. You could have an aging parent, a child that's about to go to college, a car that's got a lot of miles on it and will need major repairs—or replacement—soon, or a rental property that could get damaged by renters. It may or may not happen. But you're going to want to have a plan just in case, because your unplanned options might be undesirable. For instance, if interest rates are high, you may not want to refinance a property, not to mention use a credit card that charges 25-30% interest.

Proactive Access to Credit

Home equity

Don't forget about other options to enhance your liquidity that exist in addition to designated emergency savings. One thing you may want to access is the equity in your home. Drawing on the equity in your home for unexpected expenses may be better than taking a draw down from your investments during a market volatility cycle.

When considering home equity lines of credit, it may be advisable to work with your banker and your financial advisor to assess interest rates and compare fixed versus variable rate HELOCs (home equity lines of credit). Remember that being **proactive** with your options is the operative word here, and you may want to quickly pay back loans if they become more expensive than another option you might have access to. Think good credit versus bad credit, weighing the cost

of credit, and applying the right principles based on your own personal situation.

Line of Credit Against Portfolio

Certain portfolios and strategies allow loans or lines of credit against taxable or trust accounts. Be sure to work with a financial professional who understands this and can manage the risk paradigm on these strategies. A key component includes getting the proper leverage so you're not drawing down the investments, but instead are using the collateral. Make sure your advisor helps you use the line of credit in such a way that you're able to recoup. Sometimes these line of credit rates can be very competitive with home equity line of credit rates.

Leveraging Insurance

Obviously, life insurance can be a good way to protect your family as an important part of your overall financial and estate plan in the event that you pass away unexpectedly. Life insurance can provide sustained liquidity and cash flow for your family who must continue their lives without you.

But the cash value provided by some life insurance policies is another thing you can consider as an arrow you have available in your liquidity quiver. Certain life insurance policies have a cash value built in so that you can borrow without paying taxes on that money. You will be charged interest per the life policy's terms, but sometimes the cash value will continue crediting the policy back at a higher rate than the interest rate charged. And often you can pay the loan back on your own timeline, or never pay it back depending on the policy's crediting performance.

You must be careful not to over-borrow so that the policy remains in force, and each life insurance policy has specific contract terms you must be aware of. Every single policy is designed uniquely. But in some cases, a permanent life insurance policy with cash value might provide you with liquidity that's suitable for your situation and your needs.

Takeaways

A financial plan which includes adequate liquidity requires regular updates and reviews as your situation changes, your family members grow up, tax laws change, the economic landscape alters, and your retirement date gets closer.

If you're looking for a fiduciary financial advisor who can help you plan for liquidity in your overall financial plan, the wealth advisors at Prime Capital Financial are here to help.

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