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A Smart Move – Do an Annual Review of Your Finances

Are you making progress in reaching your financial goals? You will never truly know if you are moving forward, standing still, or falling behind in your goals unless you do a yearly review of your financial situation.

Whether your goals include saving for retirement, paying down debt, paying for your child's college education, or reducing your tax burden, a regular financial review allows you to identify and respond to changing circumstances and to plan accordingly for the year ahead. The following are important planning areas to review.

Retirement Savings

Step number one should be to calculate (or recalculate) your retirement savings goal. You will need to consider several variables -- your anticipated expenses during retirement, your sources of income, the potential for inflation, and different withdrawal assumptions. In addition, you will have to factor in any recent changes to your lifestyle that could affect your retirement outlook.

Your next step involves a careful assessment of whether you are setting sufficient money aside to reach your retirement goal. If you determine that you are falling short, consider ways you can add to the amount you are contributing. Even if you are unable to add more money to your retirement savings at this point, you should consider adding more when your circumstances change. However, focus on staying invested. While volatility in the stock market can be unnerving and may tempt you to sit on the sidelines, you should keep in mind that historically, the stock market has always recovered from downturns and delivered inflation-beating returns to long-term investors. Of course, past performance does not guarantee future results.

Your Investment Strategy

You'll want to ensure that your portfolio is adequately diversified among the major assets classes -- stocks, bonds, and cash equivalents. While diversification does not protect against a loss in a declining market, it can help you manage your portfolio's risk exposure. Any large change -- up or down -- in the investment markets can affect your portfolio's overall asset allocation. That's why it is important to rebalance your portfolio at least annually so that the percentages you have invested in stocks, bonds, and cash remain in line with your desired asset allocation. Keep in mind that asset allocation does not guarantee a profit or protect against loss. Also be aware that rebalancing a portfolio may create a taxable event if it's done outside of a retirement account.

Unfavorable changes in your financial situation, such as a job loss or large, unexpected expenses, may lessen your tolerance for investment risk. If that's the case, you may want to consider reducing your exposure to higher risk investments.

There may be other investment-related issues that concern you. For example, your current investments may not provide the income you need to meet your expenses. Or you might want to position your portfolio to keep pace with inflation.

Estate Planning

Your estate plan should include a will. A will specifies, among other things, how your assets will be distributed after your death. You may also have one or more trusts. Trusts can serve various purposes, such as helping you pass along a family business or keep your assets intact for future generations. Various events in your life may reduce the effectiveness of your estate planning. If you have experienced the illness or death of a spouse, a new job, the birth of a grandchild, the creation of a full- or part-time business, or a change in your earnings, you may have to make changes to your will, trusts, and beneficiary designations to reflect these changed circumstances.

Tax Planning

As part of your financial review, look at your current tax situation to see if you are taking full advantage of available tax credits and deductions. For starters, you may be able to lower your current year's income tax liability by increasing the amount you contribute to your tax-favored retirement plan (limits apply).

If you have children in college, learn about the American Opportunity Tax Credit (AOTC) and the Lifetime Learning Credit (LLC), two federal tax credits available to qualifying taxpayers for the payment of tuition and certain other higher education expenses. There are annual income caps on eligibility for both credits.

Your tax and financial professional can help you carefully review your overall financial situation to identify areas that may need more attention and focus.

Look Into the Future

Here are four things to consider when planning your retirement.

You don't have a crystal ball, so you can't say for sure what your retirement will look like. What you can do, however, is lay the groundwork now for the type of retirement you want. And that starts with determining where you are planning for your retirement. **It can be helpful to complete these four exercises.**

1 Imagine Your Retirement Lifestyle

How do you envision your life in retirement? Taking a realistic look at what you want to do during your retirement can help you focus and streamline your planning. Where you plan to live in retirement is an important consideration. Do you plan to stay in your current home, downsize in your current community, or move elsewhere?

How do you plan to spend your time? Do you want to work part-time, start a business, pursue educational opportunities, or simply kick back and relax? If you plan an active retirement that includes travel, you will need more money than someone who plans to stay close to home.

2 Estimate Your Retirement Expenses

Once retired, you won't have the commuting costs you might have now and you won't need to purchase work-related attire. Your children may be grown and financially independent, and you may be close to paying off larger debts such as a mortgage or home equity loan. But you will still have a range of expenses. For planning purposes, it can be very helpful to try and prepare as accurate an estimate of your basic living and discretionary expenses as you can.

Basic living expenses include housing expenses, such as energy, utilities, maintenance, property taxes, condo fees, and mortgage and rent payments. They also include transportation expenses, such as car payments, gasoline, and repairs. Groceries, insurance premiums, and income taxes are also expenses you will have to consider. Discretionary expenses include travel, recreation, gifts, and entertainment.

3 Assess Your Current Resources

In addition to the savings in your retirement plan account, you may have other sources of retirement income, such as Social Security, individual retirement accounts, military or employer pensions, and other personal savings and investments. Try to assess what they could be worth and how much income they could produce by the time you retire. Don't forget to include projected earnings from post-retirement work or income generated by a business venture.

4 Compare the Costs of Retirement to Your Anticipated Retirement Income

By this point, you may have an idea of whether you will have enough income to cover your projected expenses in retirement. If your numbers fall short, you may have to consider reducing your planned retirement spending. You could also consider increasing your retirement savings now so that you will have a larger retirement nest egg. Moreover, you could even think about pushing back the date of your planned retirement to give you additional time for saving and to boost your monthly Social Security payments.

If it appears that you are not making as much progress toward retirement security as you would like, you may want to consult with an experienced financial professional to determine what additional steps you may need to take to get you on track.