Financial Planning Amidst COVID-19, & Cytonn Weekly #26/2020

Focus of the Week

Introduction

Financial planning is the systematic approach towards managing one's finances by allocating resources in a systematic and disciplined manner in order to achieve one's financial goals and objectives. A sound financial plan is important as it helps reduce and possibly eliminate financial distress that may arise from various responsibilities and unexpected situations. Earlier in February 2020, we had discussed this topic on our Personal Financial Planning topical, however, in light of the ongoing Coronavirus pandemic that has wreaked havoc in individual's businesses, savings and financial planning efforts, we found it timely to reiterate the topic keeping in mind the new operating environment. The novel COVID-19 has greatly affected the global economy with the International Monetary Fund projecting the global economy to contract by 3.0% in 2020, a worse outlook than the one seen during the 2008-2009 financial crisis, where growth contracted by 0.8%. Due to these effects in the economy, livelihoods have been affected in one way or another and as such, people have had to adjust financially to the new environment. We shall cover the following in this topical;

i. Financial Planning Process
ii. Effects of Coronavirus on financial planning
iii. Financial planning opportunities in the coronavirus environment
iv. Factors to consider when making an Investment Decision
v. Conclusion

Section I: Financial Planning Process

As discussed above, a sound financial plan will go a long way in mitigating unexpected situations such the Coronavirus Pandemic. Financial planning is a process consisting of the following steps:

1. **Assessment:** In this step, one determines their current financial situation by identifying various factors that may affect his/her financial plan. In this step, one may ask themselves questions such as; is my salary enough for me to pursue my financial objective? What are my spending habits? etc. One's financial plan is likely to be informed by their risk profile, age, income or number of dependents. In most cases, people with fewer dependants have more freedom to make riskier investment decisions while those with a lower risk appetite tend to avoid riskier investment decisions and as such, they will be geared towards safer investment plans,
2. **Goal Setting:** In this step, one outlines the financial goals they want to achieve in the long run. These goals ultimately provide a clear roadmap towards the achievement of their financial objectives. However, the goals should be measurable and achievable by one or a combination of the following four practices:
    a. **Savings** is defined as keeping money for emergencies in a fund without the intention of generating wealth. Savings requires discipline and as such, one should treat it as a necessary expense and have a plan. It has always been stated that one should have at least 6 months of

living expenses saved up but with the pandemic, there is now need to look at a larger time frame than the 6 months,

b. Not to be confused with saving, investing is an asset or item acquired with the goal of generating income or appreciation. The main differences between saving and investing is the risk and return involved. In investing, investors take risk by investing in certain investments assets such as Equities, Private Equity, Real Estate or the Fixed Income asset class, that have the possibility of making losses while in savings, there is no risk involved and as such, the return is lower,
c. **Budgeting –** A budget is a plan that estimates the expenses and revenues over a specific period. A simple budget can help in tracking all sources of income, the expenditures as well as track all the savings such as retirement savings or what is portioned out for an emergency fund. Through a budget, one is able to know their financial flexibility for the month. Key to note is that, no one budget strategy will work for everyone, however, a budget gives one a good starting point towards financial planning, and,
d. **Debt and Debt Management.** One should always know when to get into debt and ensure that they are taking on good debt. However, not all debt is bad. Good debt is an investment that has the potential to grow in value and yield future financial gains such as business, education or property.

3. **Creation of a plan and execution.** A financial plan is developed at this step based on the goals identified in the step above. The financial plan will detail how the goals will be achieved, the time factor as well as the next actionable steps to takes towards achieving the goal. A well laid out plan should highlight the following:
   i. Suitable channels and investment instruments that will assist you in achieving your goals. This may be through saving, budgeting, cutting on expenses, and through investing, and,
   ii. Timelines: This will indicate how long you are willing to invest in a given investment instrument. Long-term investments may be most suitable for long-term goals. This is because, long-term investments offer higher returns, and long-term goals often have higher cash requirements.
4. **Monitoring and Reassessment.** This is the final step in financial planning. Given that goals and priorities change over time, it is important to monitor the financial plan created and readjust it when necessary. Before reassessing or adjusting the financial plan, it is important to consider the following;
   i. Status of the goals earlier set. A financial plan should be revised once a goal has been achieved. For the goals not yet achieved, one should determine whether they can still be achieved, given the present circumstances,
   ii. Change in income levels. When income levels change, your financial plan is directly impacted given that it may require a change in priorities. It may also lead to delay of set goals therefore affecting the laid out timelines,
   iii. Changes in risk appetite and risk tolerance. As one progresses in life, their risk appetite is set to change and as such, the financial plan ought to be adjusted to cater for this, and,
   iv. Number of dependants – When the number of dependants increases, the disposable income put towards an investments decreases, and vice versa.

Section II: Effects of Coronavirus on Financial Planning

The Novel COVID-19 which started as a global health crisis, has brought an economic downturn with most firms scaling down their operations. Consequently, this has affected individuals disposable income due to salary pay-cuts, unpaid leaves and employment termination, consequently disrupting their investments and savings plans. As economic contraction continues, most individuals have been forced to take a more conservative stance in their investments plans in order to minimize the losses incurred, maintain adequate liquidity as well as re-evaluating their short term and long-term financial goals.

The reduction in income levels for individuals who have lost their jobs, taken paycuts or unpaid leave, has set a stage for loan defaults. Given than debt management is among the goals of financial planning as discussed in the above section, the reduced income levels has put a strain on people's ability to make their monthly financial obligations to their banks. Additionally, despite the income levels declining, most monthly expenses such as rent, transport etc. have not come down putting a strain on the individual's finances. In the section below, we shall discuss the financial planning opportunities in the current operating environment.

Section III: Financial Planning Opportunities in the Coronavirus environment

Maintaining ones finances at manageable levels during this time is essential as most people are on a survival mode given the reduction in their income. In this section, we shall focus on some of the key considerations one can make in this operating environment:

i. **Scale back on spending** - Due to the financial stress arising from the effects of Coronavirus, it is important to be true to oneself and scale back on spending and minimize all unnecessary expenses. Some of the tips to attain this include:
   a. **Prioritize your expenditure-** It is advisable to only spend on the needs such as food, rent etc. as opposed to the wants such as upgrading your old phone etc. Focus your efforts on recurring and necessary bills such as electricity bills and maybe relook your entertainment budget.
   b. **Seek for alternatives –** There are plenty of alternatives you can take advantage of that will give you the same level of happiness but will cost much less. Individuals should look out for cheaper ways to achieve the same needs, and,
   c. **Look out for bargain purchases:** you can take advantage of any offers in the market as it helps save some money

ii. **Loan Restructuring:** In March 2020, Central Bank of Kenya Governor Patrick Njoroge announced that banks would provide personal reliefs on loan repayments for up-to one year to individuals affected by the effects of the Coronavirus. One can choose to restructuring there loans in:
   a. **Seeking personal relief-** this involves placing moratoriums on both interest and principal payments for three months or longer, in effect giving a reprieve to customers who find it difficult to repay their loans due to the impact caused by the pandemic, and,
   b. **Loan consolidation** – for people with more than one loan facility, they can seek to consolidate this and even request for a longer loan repayment period as it reduces the cash outflow from them.

   Key to note, the loan relief is determined at your bank's discretion.

iii. **Reformulating a budget –** Budgeting is usually described as the first step towards financial freedom. It tells you as an individual where your money is going rather than wondering where it went. Given the reduced disposable income, a budget will ensure that you determine whether the available resources are sufficient to cater for your monthly expenses and if not, it provides a clear picture on where you can scale back in order to live within your means. It is also through a budget that one is able to know their financial health and identify any disposable income available for investing. Key to note, sticking to a laid out budget requires discipline and the truth of making a really good budget more so in this economic downturn is, you have to be honest about where your weaknesses are, most especially in areas you can be saving more money,

iv. **Review and update your Investment Plan –** Based on your current financial situation, it is important to review and update your investments plan to ensure you are comfortable with your investment allocation in the various investments asset classes. Individuals whose income levels has been affected should revaluate their investment strategies to a low risk plan. Given that liquidity is the most important goals at the moment, investors should focus on short-term investments such as Unit Trusts as opposed to investing in long term illiquid assets such as the

Real Estate Sector. The economic downturn has seen most investors recorded losses in their portfolios and as such, rebalancing your financial plan will help in minimise the loses in your portfolio as well as assist you in staying the course of your short-term financial goals, and,

v. **Re-evaluate the Emergency fund –** It is important to have an emergency fund that is easily accessible and can cover at least three months of your living costs. With the slow economic growth anticipated globally, emergency funds will come in handy during this time. With companies scaling back their operations and cutting costs, most people have found themselves either taking paycuts, being laid off or taking unpaid leave. If you are lucky enough to not have lost your job or if you took a paycut, given the scaling back of expenses, your residual income can be directed towards an emergency fund. Think of it as your SOS fund should anything go wrong.

Section IV: Factors to consider when making an Investment decision

Even in the middle of the pandemic, it is important to ensure that we continue investing in a bid to ensure we are growing wealth or at least preserving value. It is important to ensure that investors are getting at least a return above inflation in the long term. A lot has changed due to the ongoing Pandemic with various assets classes being impacted differently. We have covered some of the effects on this on the various weekly reports such; Impact of COVID-19 on Kenya's money market funds, Impact of COVID-19 on Kenya's Real Estate Sector, Impact of COVID-19 on Kenya's Real Estate funds. Now it is more important than ever for investors to ensure that they are making the right investment decisions. Below are some of the factors to consider while making an investment:

a. **Return:** This are the profits made from an investment. A rational investor seeks out a venture that would provide maximum return for a given level of risk. The choice of investment depends on the returns available and the preference of the investor towards generating a stream of income or capital appreciation in their portfolio,
b. **Risk Tolerance –** One of the general rules in investments is, the higher the risk, the higher the return. It is important that before investing, know your risk tolerance. Not everyone is comfortable in investing in risky assets classes such as the Equities market. It is therefore important to take on calculated risks and stick to a risk/reward ratio suitable for your risk appetite,
c. **Liquidity:** This refers to how quickly one can convert an asset to cash. Key to note, liquidity varies from one asset to another. For individuals looking for liquidity amid the pandemic, it is important to consider investing in short-term liquid assets,
d. **Time Horizon**: What an investor hopes to achieve will determine the type of investment they venture into. Before investing, an individual must evaluate the target for the investment chosen and the length of time for which they require illiquid assets. The investment horizon determines the investor's income requirements and desired risk exposure, which then helps in choosing the appropriate investment product, and,
e. **Investments Capital –** The amount of investment capital one has often affects their choice of investment given that some investments require higher capital, thus making it harder for investors with lower capital to invest. In the current market, one can invest in the equities market either directly on their own or via Collective Investment Schemes such as Equity funds (which buy ownership in businesses most often in the form of publicly traded common stock), with as little as Kshs 1,000 or invest in government papers using Collective Investment Schemes such as Money Market Funds with as little as Kshs 100 in select Money Market Funds,

When one has decided what they want to invest in, the next step is to determine how they would like to invest. One can choose to invest directly or through a collective scheme. Collective Investment schemes (CIS) are pools of funds that are managed on behalf of investors by fund managers. The amounts invested in the CIS are pooled and utilized by fund managers to buy stocks, bonds or other securities that are in accordance with the funds objective, with the aim of generating returns for their investors. Direct investors on the other hand, own particular investment assets on their own and are responsible for the management of their portfolio/ investments. Direct investors reap all the rewards and assumes all risk as opposed to investing in a CIS.

Below is a summary of some of the pros and cons of investing through each type;

	Advantages	Disadvantages
Collective Investment Schemes	1. **Diversification -** Given that the funds invest in various asset classes as well as different firms, investors have access to a broad range of securities they can invest in as opposed to individual investing, 2. **Liquidity -** CIS ease the process of buying and selling units compared to investing directly in shares of firms whose opportunity to transact depends on the supply and demand at the time, 3. **Professional Fund Management -** CIS gives investors the opportunity to tap into the expertise of fund managers who have crucial information of the market, and, 4. **Access to broad investment assets -** Through Collective Investment Schemes, investors gain access to investment products inaccessible to an individual investor such as government and corporate bonds, which are restricted to institutional investors.	1. **Management Fees** – These are the fees paid to fund managers and is often a percentage of the Assets Under Management (AUM), 2. **Flexibility** – Collective investment funds are managed in accordance to the funds objective and must have a certain allocation in each asset class. This limits the investors choice of investment, and, 3. **Tax** – The management fees charged in the CIS are not tax deductible
Direct Investment	1. **After Tax Returns-** When investments are held directly, the income generated is separated from any growth in the portfolio before tax is levied, and, 2. **Transparency and Flexibility –** Through direct investing, an individual is able to track their investment at any point in time.	1. **Limited access to investment assets** due to limited capital, 2. **Lack of investment expertise.** Without some financial expertise, individuals may assume more risk than they intended to and may invest in a random fashion**,** 3. **Time consuming.** Monitoring and keeping track of one's portfolio can be time consuming given the amount of research an individual needs to conduct in order to manage their own portfolio, and, 4. **Diversification –** personal investing is risky given that one bad investment can have a negative impact on your portfolio.

In light of the current economic conditions, with CIS, investors with low levels of income are able to access various investment avenues such as the Money Market Fund. Money Market Funds for instance, have continued to record higher returns as compared to bank deposits and saving accounts during this economic downturn.

Conclusion

As the global market continues to show signs of distress and fluctuation, financial planning will provide a clear path on navigating the stressful situation caused by the pandemic. Investing in the right assets to fit ones objectives is of paramount importance. It is therefore important to ensure that you are constantly updated on what is happening in the market given that this will enable you to make the right investment decisions that are in line with your goals. Getting the right investment partner is paramount and as such, an investor should ensure that they vet their investment partners in order to gain the maximum insights in regards to their investments. One should also continuously assess if their financial circumstances have changed and readjust their financial plans accordingly.

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