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How to Self-Diagnose Your Financial Health

by Tara Siegel Bernard
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You probably get an annual physical. Your doctor will ask about your concerns, take your blood pressure and 30 minutes later you're out of the paper gown and off to work -- maybe with a new prescription for Lipitor.

A similar annual checkup takes place in another type of practitioner's office: financial planners. But instead of analyzing your good and bad cholesterol levels, a planner may evaluate your good debts mortgage and bad debts (credit card). And instead of testing your reflexes, they may look at your savings and assess your ability to respond to a financial emergency.

"A lot can happen in a year," said Andrew V. Tignanelli, president of the Financial Consulate in Hunt Valley, Md. "Markets change, phone numbers change, beneficiaries change, tax laws change and your life changes."

With that notion in mind, we asked planners what they ask their clients during their annual financial physicals. Their questions can help you diagnose your financial situation:

Is Your Net Worth Growing?

Your net worth is one of the best barometers for measuring financial health, and it provides an easy way to detect whether a longer-term problem may be emerging, several planners said. To make the calculation, you simply subtract what you owe (your liabilities) from what you own (your assets). So even if your assets are not growing, your net worth will improve if you are paying down debts. There are tools and calculators on the Web that can serve as a guide, like one at Mint.com, which can be linked to most of your accounts and provide real-time updates. (Not that you want to obsess over this number. You just want to measure your progress each year).

"One of the quickest ways to take the financial temperature of a client is to track their balance sheet from year to year," said Walt Mozdzer, a financial planner in West Des Moines, Iowa. "If you track the client's net worth progression, you can quickly tell if they are saving money, living within their means and/or more likely be on track to reaching their financial goals."

A decline in net worth isn't always a bad thing, but you want to understand why it has dropped, explained Cheryl Krueger, a financial planner in Chicago. "Are your assets lower because you're spending more than you're earning or because of an external factor like a market downturn? Are your debts increasing or decreasing?"

Increasing debts may be O.K. if you are advancing your education or starting a business, she added, but obviously not if you are simply spending to keep up with the Joneses.

How Are Your Ratios?

Several experts also recommend looking at a few crucial numbers, or ratios: your debt-to-income ratio, your savings rate and emergency funds.

"It begins to give us a good snapshot and longer-term trend of what is happening in their financial lives and whether changes need to be implemented," said Patrick Collins of Greenspring Wealth Management in Towson, Md. "We set a target for each one of them."

The targets will vary depending on where one is in life. Younger people should dedicate no more than 30 percent of gross income to pay for all debt (car payments, mortgage, student loans, revolving debts), he said, and that should gradually decline to zero by the time they are ready to retire. As for savings, he said, everyone should aim to save 15 percent of their salaries, while empty-nesters preparing for retirement should rev up their savings to 20 to 25 percent. Understandably, you may miss these targets when you are struggling to pay for your children's college or saving for a home (especially on the coasts). Meanwhile, your emergency fund should contain about six months of expenses in cash, Mr. Collins said, while retirees should set aside one year's worth of fixed expenses.

Are You Spending More Than You Earn?

Using an automated service is probably the easiest way to track spending. Many experts recommend using one of the popular programs like Quicken or online services like Mint.com, Wesabe.com or YouNeedABudget.com. Obviously, if you are living on a fixed income, this becomes even more important -- establishing monthly spending targets makes it easier to track.

"The problem with most people's finances is that they talk about it, but they never consolidate and organize their financial data in an easily manageable way so that they can know at any given time exactly where they stand," said Bedda D'Angelo, president of Fiduciary Solutions in Durham, N.C.

What Has Changed in Your Life in the Last Year?

Big life events can disrupt even the best strategies. Getting married, having a child or even becoming eligible for Social Security or Medicare will require that you make many financial decisions.

"The main question here is really, 'What has changed in my life that may change items in my financial plan?'" said Rick Kahler, a financial planner in Rapid City, S.D. "A person may need more or less insurance, update their investment philosophy, save more or less for retirement."

Are You Still Adequately Insured?

Evaluating the costs and amounts of your homeowners', renters' and auto insurance policies should be an annual or biannual exercise. Consider raising your deductibles because that can lower your premiums. You might be able to lower your costs further by picking up an umbrella policy, which provides additional liability coverage, said Steve Podnos, a financial planner in Merritt Island, Fla. To do this, you would lower your liability coverage on all of your other policies to the minimum required by the umbrella policy, and then use the umbrella policy to pick up the difference, he said. This is especially important for families with teenagers.

"As kids turn 16 and begin driving, the family liability skyrockets," Mr. Podnos said. "Anybody of any means should probably have an umbrella policy. It's the cheapest coverage you can get in terms of millions of dollars of coverage per premium dollar."

Next, turn your attention to disability and life insurance coverage. Do you have enough? Too much? A good rule of thumb: about 20 times salary for life insurance (for one or both spouses) minus any other resources you may have. If you are approaching retirement, you might consider dropping some or all of your disability or life insurance coverage if you have it (and maybe swapping it for a long-term care policy).

"Once you hit your 60s, disability insurance is expensive," Mr. Podnos said. You are paying a premium for what will amount to only a few years of coverage, since most policies stop paying at age 65 or shortly thereafter.

Do You Need to Make Any Changes to Your Estate Plan?

Start by making sure the beneficiaries you have named -- on things like your retirement accounts or your life insurance policies -- are up to date. You also want to review the people you have named as guardians for your children, executors, trustees and those with powers of attorney.

"Are they still the best choice for the job?" asks Jon P. Beyrer, a financial planner in Solana Beach, Calif.

Estate planning documents like wills and trusts also need to be reviewed and possibly updated. (Did you buy anything this year that needs to be transferred to your revocable living trust?) And given the uncertainty surrounding the estate tax, families with taxable estates need to make sure their documents are written to account for that uncertainty.

"If it's more than five years old, it needs to be looked over by an attorney," Mr. Podnos added. Also make sure your advance health care directives and health care proxies or medical powers of attorney are in place.

How Are You Sleeping? Does Your Portfolio Require Any Maintenance?

The economic collapse reminded many investors that they tend to overestimate their tolerance for risk and volatility. That is why several planners suggest asking whether you can meet your goals with fewer risky investments like stocks. This is also the time to see whether your portfolio requires rebalancing to your target asset allocations, which many planners recommend doing at least annually. As you get closer to retirement, financial planners also begin to project whether your portfolio and other sources of income can sustain your current lifestyle. If you are off track, you need to consider incorporating potential solutions to make up for the shortfall.

Have Your Outlook or Goals Changed? Are You Happy?

At its core, financial planning is not simply about money. It is about finding the best way to finance what you want out of life, whether that is spending more time with family and friends or traveling. And planners use their annual checkups to help clients make sure they are doing that.

"We encourage people to ask themselves what they can do to be happier and better off a year from now, whether that is saving more money, paying off debt, changing careers or doing more charitable work," said Dan Serra, a financial planner in Plano, Tex. "It's a mix of evaluating life and money."