

THE IMPORTANCE OF STRESS TESTING YOUR WEALTH STRATEGIES

Stress testing is a process that carefully examines your current wealth planning strategies to assess the likelihood that they'll deliver the results you expect them to in various environments and situations. Stress testing is also a powerful way to identify any gaps between what is truly important to you and your family and what your wealth plan currently calls for.

Successful families often have stress tests conducted because the results can promote intelligent decision-making, verify they will likely achieve their goals, and confirm they are dealing with competent professionals. Just as you might get a second opinion from a tax attorney before implementing a tax mitigation strategy, stress tests can also be effective at identifying big problems—or potential huge mistakes—so changes can be made proactively. Stress testing is like an annual medical checkup. There may not be anything wrong, but it is a perfect way to **catch a problem before it becomes severe.**

The good news: You don't have to employ your own 'family office' to benefit from a stress test. We believe it should be part of everyone's due process when vetting financial plans, products, and services. In addition to identifying potential missteps in an existing plan or service, it may be able to deliver some peace of mind when the test confirms that your plan is indeed on track.

THREE CATEGORIES OF STRESS TESTING

- 1. Investments** - How will my investments perform in a significant market downturn? Do my investments match my financial goals? Am I properly diversified? Are fees eating into my returns?
- 2. Transitional** – If I get hit by a bus today, what am I leaving behind for my heirs to clean up? Is my house in order?
- 3. Behavioral** – How will I respond to market events? Will I react to them and potentially make significant financial mistakes?

FOUR STEPS OF STRESS TESTING

- 1. Profiling.** The process starts with discovery. What are your specific goals and concerns? What problems do you want to solve? What opportunities are you seeking to benefit from?
- 2. Solution evaluation.** Various strategies or products can be assessed once there is clarity about your goals, objectives, concerns, and limitations. There are numerous ways to dissect and evaluate solutions, including:

- **Working the assumptions.** The strategies or products' assumptions are systematically changed to determine how they are likely to work when circumstances change.
- **Evaluating alignment with goals and objectives.** It's essential to determine whether the strategies and products likely will accomplish your goals and objectives. A solution might be high quality but still not deliver the specific results you want or need.

3. Analytic comparisons. Based on the evaluation, alternative solutions may be considered. It can be advantageous to conduct side-by-side comparisons of these solutions.

4. Recommendations. After stress testing, recommendations are presented and considered—and the next course of action is decided on.

STRESS TESTING TRENDS AMONG ADVISORS

Because of the power of stress testing, we make it a cornerstone of the way we work with individuals and families. Consider that a sizable majority—76.8 percent—of 181 senior executives at family offices call stress tests an essential service for their clients.

Those stress tests focus primarily on investment management solutions, with other areas like life insurance and wealth planning getting attention to varying degrees. In our view, an intensive focus on just investment management may be too limiting. **An example:** while just around 40 percent of the executives surveyed have stress-tested clients' life insurance, 64.4 percent of those execs uncovered problems requiring corrective actions. This doesn't surprise us. Many families purchase life insurance to address estate tax concerns. Sometimes, life insurance is obtained to create a more significant estate or to make a charitable gift at death. Other times, the intent is to benefit from the tax-free internal buildup. But, commonly, some of these families end up with amounts of life insurance that exceed their wants and needs. Additionally, their life insurance may be poorly structured. When life insurance portfolios are not in sync with wealth planning strategies, trouble can occur down the road. **This suggests that stress tests should be widely applied to other areas of clients' financial lives.**

LOOKING DEEPER

Many plans fail because of lack of attention to the **human element** — the part of planning that focuses on understanding everything and everyone important to your family—as well as everything and everyone that could be affected by decisions concerning your finances. Technical proficiencies are critical, but problems often result from crossed wires or failing to think through what *actually* matters to you and your family. Stress testing is one of the ways we prepare you and your wealth plan to endure any number of circumstances. Additionally, putting your plan through its paces also enables us to defend you from things that could get in the way of getting what you want out of life.

- THE DENT WEALTH TEAM