Liquid Term

ASSESSMENT GUIDE

Liquid Term (Lt) indicates the number of years a client could live on their current liquid assets at their current lifestyle if neither changed.

Elements®
Financial Planning System

Liquid Term

Assessment Guide

What is it?

Liquid Term (Lt) indicates the number of years a client could live on their current liquid assets at their current lifestyle if neither changed.

CALCULATION

Total Liquid Assets

÷ Annual Living Expenses

Liquid Term

Liquid assets include all cash accounts (checking, savings, CD, business cash, etc.) and after-tax investments (brokerage, insurance cash value, after-tax annuity, etc.)

> **Example:** if a client has $50,000 in cash and $300,000 in brokerage accounts, and they spend $100,000 annually, then their Liquid Term score is 3.5.

Why is it important?

Keeping adequate liquidity means having enough money in the bank and/or after-tax accounts to weather the unexpected or pursue the next stage of growth in your clients' lives.

Without adequate liquidity, clients can feel more stressed about day-to-day decisions and become less able to see the big opportunities in front of them. Maintaining the right amount of liquidity can help them feel less anxious about their finances in turbulent times and give them the confidence they need to live in the moment.

However, as in all things, finding balance is critical. There are certainly times where clients might need to be willing to sacrifice some liquidity for the right investments and opportunities.

How do I use it?

The following process can be used to assess whether a client's Liquid Term is appropriate or if they need to make improvements:

1. **Accuracy: ensure the accuracy of the Liquid Term inputs.**
2. **Assessment: assess whether the given Liquid Term is appropriate.**
3. **Improvement: Identify areas of improvement**

STEP 1

Score Accuracy

To calculate Liquid Term all you need is an up-to-date net worth statement and an accurate spending number. For details on ensuring the accuracy of these inputs, reference the Burn Rate (for spending) and Total Term (for net worth) assessment guides.

STEP 2

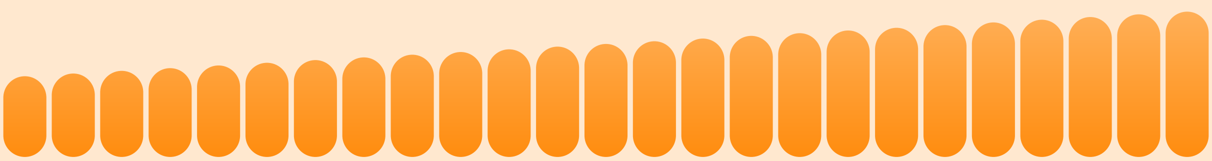
Score Assessment

Note: *While important to understand a client's Liquid Term by itself, all Term scores are typically best assessed together to be able to compare total asset mix, holistically.* *See the Total Term assessment guide for more details.*

While Liquid Term combines both cash and after-tax investments, it's a good proxy to measure emergency expense preparedness. For example, a Liquid Term of 0.5 indicates 6 months of expenses covered, and if the underlying mix of that score is mostly cash, then this client might have a good buffer for unexpected expenses.

CORRELATING FACTORS

Understanding the correlation between the below factors and your client's Liquid Term will help you determine if the given score is appropriate or not.



Lower Lt Scores	**Higher Lt Scores**
Early Career Stage	Upcoming Purchases
	High Income Variability
	High Growth Business Stage
	Larger Family

STEP 3

Score Improvement

Underlying assets composing a client's Liquid Term include cash and after-tax investments. Finding a healthy balance among these should be your top priority when improving your client's overall liquidity position.

In addition to finding balance in these assets, consider the following questions:

- Should the client increase their liquidity?
- Does the client have an emergency fund? And how long will it cover? (i.e. 3 - 6 months)
- Does the client have any upcoming purchases or investments they need liquidity for?
- If the client wants to aggressively pay down debt, what Lt score should they have before pursuing that?
- For business owner clients:
  - Should they make use of idle business cash?
  - Do they have enough cash to cover overhead for a couple months?

Case Study

Let's look at the following example and apply the principles presented above. This case study assumes you've already ensured that you have a good estimate.

Example: Given the following Elements scores and additional information, you begin your assessment of whether a client's Liquid Term is appropriate.

Lt = 1.7	Qt = 4.1	Rt = 1.1	Bt = 6.0	Tt = 12.9

Upcoming Purchases?	**Down payment on rental property**
Career Stage	**Mid-career**
Family Size	**Married, 1 child**
Income Variability	**Highly variable**
Business Growth Stage	**Early, high growth**

Step 1 - Score Assessment: As part of the client's total asset mix and considering their small family size, their low Liquid Term seems healthy.

However, recognizing that they have an upcoming purchase, have highly variable income, and their business is experiencing high growth, their liquidity needs are not met with the current score of 1.7. From this assessment, you determine that the client should increase their Liquid Term.

Step 2 - Identify Improvements: You'll first focus on improvements to the client's Savings Rate in order to increase their total liquidity.

After this, you resolve to build the client's cash position over after-tax investments. Because the client is in high growth for the business and they have a large down payment due within the next 6 months, they'll need access to cash quicker.