

HOW TO SELF-DIAGNOSE YOUR FINANCIAL HEALTH

You probably get an annual physical. Your doctor will ask about your concerns, take your blood pressure, perform other basic tests, and 30 minutes later you're out of the paper gown and on your way — likely with a few recommendations of action and possibly with a new prescription or two.

A similar annual checkup should take place from a personal financial perspective. But instead of analyzing your good and bad cholesterol levels, a financial planner may evaluate your good debts (mortgage) and bad debts (credit card). And instead of testing your reflexes, a planner may look at your savings and spending levels and assess your ability to respond to a financial emergency.

As with your medical situation, a lot can happen in a year from a personal financial perspective. Markets change, employers/employment status' change, beneficiaries change, tax laws change and your life changes. With that notion in mind, here are some questions to consider to help 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. 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 and monitor your progress each year.

One of the quickest ways to take the financial temperature of one's financial health is to track your balance sheet from year to year. Through tracking your progress over time, you can quickly tell whether you're saving money, living within your means and/or more likely to be on track to reaching your financial goals.

A decline in net worth isn't always a bad thing, but you want to understand why it has dropped. Are your assets lower because you're spending more than you're earning or because of an external factor like a market and/or housing downturn? Are your debts increasing or decreasing? Increasing debts may be O.K. if you are advancing your education or starting a business, but obviously not if you are simply spending to keep up with the Joneses.

How are your ratios?

In addition to your net worth, there are several other crucial personal financial numbers, or ratios including: your debt-to income ratio, your savings rate, and emergency funds. As with the net worth figure, determining and monitoring these metrics over time provides you with a good snapshot and longer-term trend of what is happening in your financial lives and whether changes need to be implemented. A financial planner can help you set a target for each one of them.

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

Are you spending more than you earn?

By far this is the single greatest determinant to one's financial success. If your spending exceeds your earnings, there is no money leftover to be allocated towards achieving your financial goals. Using software or an automated service is probably the easiest way to track spending. Options like Quicken or online services like Mint.com, Wesabe.com or YouNeedABudget.com are popular. 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 and have great intentions, but they never get around to consolidating and organizing their financial data in an easily manageable way so that they can know at any given time exactly where they stand against their plan or budget.

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?' Depending upon the change, a person may need more or less insurance, update their estate planning, switch investment philosophy, save more or less for retirement.

Does your portfolio require any maintenance?

The recent economic environment reminded many investors that they tend to overestimate their tolerance for risk and volatility. Could you possibly achieve your financial goals with fewer risky investments like stocks. This is also the time to see whether your portfolio requires rebalancing to your target asset allocations, a process which should be performed at least annually. As you get closer to retirement, you certainly want to 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.

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. 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. This is especially important for families with teenagers. As children turn 16 and begin driving, the family liability skyrockets.

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. 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. The question to ask yourself: Are they still the best choice for the job?

Estate planning documents like wills and trusts also need to be reviewed and possibly updated. 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 your estate plan documents are more than five years old, they need to be looked over by an attorney. Also make sure your advance health care directives and health care proxies or medical powers of attorney are in place.

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 financial planners use their annual checkups to help clients make sure they are doing that. Ask yourself what you 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. Ultimately, it's a mix of evaluating life and money and finding the right balance.