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Financial Planning for Young Working Professionals

by William Cai

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For this scenario, we have a young couple, both professionals aged 25 and earning $3k each.

The Early Stage – What's Coming

1) Home

Firstly, the couple would have to prepare for the purchase of their first matrimonial home. Assuming that they would be applying for a 4-room HDB flat at an estimated cost of $300,000:

- They would have to first fork out an option fee of $2,000, which is affordable for most couples.

- If the couple takes a 90% loan, the bigger outlay would be the 10% downpayment of about $30,000, which can be accumulated in their CPFOA in about 2 years.

- The monthly instalment for a $270,000 loan for 25 years at 2.6% p.a. would be about $1,223 p.m., which can be covered by the couple's salaries.

- What the couple would need to save up for are renovation and home fixtures, which could cost $20,000 or more, depending on their preferences. It is important that they spend a minimal amount here, as it is ultimately an expenditure that adds little to the value of the home. What's more important is setting aside more money to invest for the future.

2) Wedding Banquet

Secondly, the couple should start saving for their wedding banquet. This can cost them from as low as $500 to $1,800 per table or more. While it is a common practice for couples to receive monetary gifts during their wedding banquet, couples are advised to have at least 50-60% of the banquet cost on standby – just in case.

	Number of Tables		
Cost Per Table	25	30	50
$500	$12,500	$15,000	$25,000
$1,000	$25,000	$30,000	$50,000
$1,800	$45,000	$54,000	$90,000

3) Savings

Thirdly, young couples should save hard. Assuming that the couple each accumulates $10k p.a. at zero growth, by the end of 5 years they would have accumulated $100,000. By then, their wedding and home establishment costs would have been settled and they would have the peace of mind to invest for the next 30–40 years of their lives. Saving early would allow the couple to enjoy the power of compounding returns in the later years.

	Rate of Return					
Years	3.50%	4%	6%	8%	10%	12%
30	$280,679	$324,340	$574,349	$1,006,266	$1,744,940	$2,995,992
40	$395,926	$480,102	$1,028,572	$2,172,452	$4,525,926	$9,305,097

- Saving in a traditional insurance endowment plan is fine, but many couples make the mistake of being too conservative when they are young. Being too conservative just doesn't pay, and the difference can be seen from the table provided.

- Most investors, young or old, misunderstand risks and volatility. Risk, to me, means total loss. Volatility simply means deviation from the mean (i.e. the average) return. Investing in a diversified and carefully selected portfolio of equities helps to prevent total loss. History has shown that if investors can ignore short term volatility, they will be rewarded over time.

- Investors should also spend time studying the historical risks of different portfolio mixes of equities and bonds to select one that best suits their temperament. The study of historical drawdowns over a period of more than 30 years is important in order to get a sense of how their portfolios can behave. This can help them avoid the mistake of panicking and pulling out when the markets move sideways for a lengthy period of time, or during bear markets when portfolios fall in value.

Those who are more conservative and prefer lower volatility can include a 20-30% mix of bonds into their investment portfolio.

The Second Stage – Establishment of Family

As a family is established, assuming the couple have 3 kids, much of their income would go towards them. Sending 3 young kids to nursery, kindergarten and enrichment classes, plus the provision of transport and engagement of a maid, can be an expensive affair. As a result, saving can become a little challenging for those whose income has not grown substantially during this stage. This is when they would realise the value of their earlier savings.

Insurance Needs

Buying insurance must serve two purposes: it must be comprehensive and adequate.

They should be covered for Death, Total and Permanent Disability, Partial Disability, Disability Income Needs, Critical Illness, and Hospitalization.

As they go through the life cycle, their insurance coverage will typically rise as they start a family. It will only lower when their children become independent and when their nest egg has growth to a sizable amount.

It is not uncommon to see someone with 3 to 5 policies, but what I find disturbing is that many, young and old professionals alike, are insufficiently covered for $200,000 or less. This tells me that their insurance needs have not been properly established. To provide an income of $30K p.a. for an age 25 professional to age 65 would require $1,000,126 (inflation 3%, growth 4%). If you factor in the living needs of children and parents, the figure can easily hit $2m.

An affordable way to boost insurance coverage would be to buy a combination of a level term and decreasing policies to cover the relevant period of risk. Whole life policies with a saving element can be handy, but they will be too expensive for most to buy a $2m cover, and they would not be suitable for needs of only 20–30 years. Term policies are undersold in Singapore, but males who have served in the Singapore Armed Forces can complement their insurance plan with SAF and SAFRA group term policies, which are very affordable. A $1m SAF Group Term Life cover till age 65 can cost as little as $128 pm. A $300,000 Critical Illness cover starts from as low as $30 p.m.

Lack of Desire to Save and Invest

The German proverb 'He who saves in little things, can be liberal in great ones' still applies to us in modern times.

Singapore has become an affluent country, and many young professionals today come from middle-class or well-to-do families. Through my profession as a CFP, I have noted that this group of professionals has been conditioned by their parents to enjoy a certain lifestyle. They have regular meals at restaurants, go for regular holidays, spend to dress fashionably, and aspire to own a car. It's not that they are reckless, but they have had a blessed life that unfortunately did not condition them to want to save hard.

On the other hand, I know of a few young professionals who are hungry to start saving, learning to invest their money at an early age. They typically come from a humble background and somehow have a fire in their belly that is different from the first group mentioned.

The advice of working hard, leading a frugal life and saving hard is still true, and timeless.

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