SF&PD
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financial $UCCESS

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Answer These Questions Honestly

Trying to determine whether all your finances are in shape? Answer these questions honestly to determine places where you may need to shore up your finances:

Do you have a financial plan? It's difficult to achieve your financial goals by accident. Typically, you'll need a formal plan that includes steps to help achieve your goals and ways to assess your progress along the way.

Do you know your net worth? Prepared at least annually, a net worth statement can help you assess your financial progress. Ideally, your net worth should grow by several percentage points over inflation.

Are you saving something from every paycheck? Saving on a consistent basis is one of the best habits you can develop to help you achieve your financial goals. Having trouble finding money left over to save? Find ways to make saving automatic. Increase your 401(k) contributions or have money automatically withdrawn from your checking account every month and deposited directly in an investment account.

Do you have a budget? Almost no one enjoys the process of analyzing and budgeting expenditures. But inefficient and wasted expenditures can be major impediments to accomplishing your financial goals. It is difficult to control your money if you don't know how much you have or where it is going.

Is your debt becoming burdensome? Just consistently spend a little more than you make over a period of time and you will eventually find yourself overburdened with debt. At that point, with much of your discretionary income going to make debt payments, you may have little or nothing left over to save. If your debt level is too high,

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Answer These

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take steps now to get your debt under control.

Do you own a home? While owning a home is not for everyone, there are significant financial and tax reasons for doing so. Although you typically only make a down payment of 10% to 20% of the home's cost, you retain all price appreciation on the home. Part of each mortgage payment builds equity in your home. Historically, homes have provided a good hedge against inflation. There are also significant tax advantages to home ownership, including tax deductions for mortgage interest and property taxes and exclusions of significant amounts of gain when selling.

Are you prepared for financial catastrophes? Make sure to have an emergency fund covering several months of living expenses, insurance to cover catastrophes, and a power of attorney so someone can step in and take over your finances if you become incapacitated.

Are you earning as much as you can? Sure, we all want to enjoy our work. But within that parameter, why not choose a job that will pay more? Your income is going to drive all your other financial decisions, so investigate your options. Are you sure you're being paid a competitive wage? Do you have an outside interest or hobby that can be turned into a paying job?

Are you utilizing all appropriate strategies to reduce your income taxes? Assess your tax situation, looking for ways to reduce your tax bill. It often helps to discuss these items with a professional who can review strategies you might not have considered.

Is your portfolio properly diversified? Typically, you do not know which asset class will perform best on a year-to-year basis. Diversification is a defensive strategy — it helps protect your portfolio during market downturns and helps reduce your portfolio's volatility. Diversify your investment portfolio among a variety of investment categories, as well as within those categories.

Do you rebalance your investments at least annually? Your portfolio won't stay within your desired allocation by itself. Since different investments earn different rates of return, over time, your allocation will get out of line. Review your portfolio periodically and make adjustments to rebalance it.

What rate of return have you estimated for your investments? Expected rates of return are often derived from historical rates of return and your current investment allocation. Actual returns may be better than that in some years and worse than that in other years. You might want to be more conservative than that, assuming a rate of return that is lower than long-term averages.

Is your estate plan up to date? Take a fresh look at your estate planning documents. Even if recent increases in exemption amounts mean your estate won't be subject to estate taxes, there are still reasons to plan your estate. You probably still need a will to provide for your estate's distribution and to name guardians for your minor children. You should also consider a durable power of attorney, which designates someone to control your financial affairs if you become incapacitated, and a health care proxy, which delegates health care decisions when you are unable to do so.

Are your retirement plans on track? You want to be sure your retirement savings and other income sources, such as Social Security and pension benefits, will support you for what could be a very lengthy retirement.

If you need help reviewing any aspect of your finances, please call your financial advisor.

Stretching Your Salary

In the current economic climate, many employers are cautious about increasing expenditures. That means your best bet for the near term is to make your current salary stretch farther. Some tips to consider include:

Deposit your paycheck directly into your bank account. That way, you'll be less tempted to cash part of your paycheck and spend it.

Contribute to your 401(k) plan. Any contributions you make are deducted before income taxes (unless contributing to a Roth 401(k) plan), so you don't pay any current federal income taxes on your contributions. In addition, many employers match some portion of your contribution.

Check out your 401(k) investments. Since you are responsible for investing your contributions, make sure you are familiar with all options in your plan and review those options at least annually. Even if you only increase your rate of return by a percent or so, that can make a significant difference in your ultimate balance.

Review your health insurance coverage. If your employer offers more than one option, review those choices carefully. When your spouse also has coverage, review options from both employers and determine which is the best alternative for you.

Take a look at other fringe benefits offered by your company. Many employers provide a variety of fringe benefits. Usually, you do not have to pay any income taxes on these benefits. Thus, carefully assess your company's fringe benefit package to ensure you are utilizing all appropriate ones.

What's Better: Saving or Paying Down Debt?

The Great Recession has drilled home a lesson many people seemed to forget: debt can be dangerous to your financial health. Is it better to save or pay down your debt first?

The answer depends on a lot of things that are unique to each individual, such as how old you are, how much you've already saved, what rate of interest you're paying, and more. A review of the basics of financial planning is a good way to approach the subject. Here we outline how you should use income not dedicated to day-to-day expenses, in order of priority.

First Priority: Insurance

One of the best routes to financial ruin is to not have adequate insurance, so your first priority should be to have the right kinds of policies in the right amounts that protect you and your family. If you're young and unmarried, this means having basic health insurance. Beyond that, if you have a family, you need life insurance as well as short- and long-term disability insurance. In each case, you're looking to provide yourself or your survivors with a replacement for the income you and they count on. The bottom line: if you have debt, make the minimum payments until you're properly insured and you have the next two priorities covered as well.

Second Priority: An Emergency Fund

Even if you don't have a family, you need to protect yourself against job loss or a major unexpected expense. The rule of thumb is to create an emergency savings fund equal to three to six months of your income. Not only does this give you breathing space against hardships, it also affords you the flexibility to move in connection with a job change.

You should make creating an emergency savings fund a priority. If you can't take care of priorities one and two at the same time you pay for basic necessities, like groceries and gasoline, you're living beyond your means and need to cut back on your spending.

Third Priority: Retirement Savings

Finally, before you even think about making more than the minimum payments toward your debts, it's imperative that you start saving for retirement, as soon as possible. Time is both the best ally and worst enemy of the saver. Start saving too late, and it's possible that you'll need a rate of return you can only achieve in your dreams in order to accumulate enough for a worry-free retirement. On the other hand, even small amounts — as little as $25 a month — put away early enough can grow to sizable amounts by the time you're ready to retire.

With these three priorities covered, when you have money left over, it's time to consider making extra payments to tackle your debt.

Guidelines for Debt Reduction

There are a number of factors to consider when you're ready to start accelerating the pace at which you pay down debt:

✔ **Start with the debt with the highest interest rate.** Instead of paying more on every one of your debts, concentrate on the one that charges the highest interest rate. In general, these will be store credit cards, followed by bank credit cards like Visa and MasterCard. Use all your spare cash flow to pay them down one at a time.

✔ **Is it tax deductible?** Debt that you can write off against your taxes is generally considered "good debt." In effect, the tax deduction reduces the interest rate by your marginal tax rate. In most cases, this means home mortgage interest.

✔ **What rate of return can you expect?** The most important consideration is whether you can earn more by investing your money than the interest rate you're being charged on your debt. If you can earn more in the financial markets than your interest rate, you should invest your money instead of paying off the debt. If not, it's worth it to pay off the debt.

✔ **How long until you retire?** This is a key consideration when you're thinking of paying off your mortgage, especially if it's near the end of its term. At that point, the tax benefits are minimal because most of your payments consist of principal, not interest. In addition, if you're 50 years old or older, the monthly cash flow you'd free up could be devoted to the extra $5,000 a year you can contribute, pretax, to an IRA or 401(k).

On the other hand, if you have 10 years or more to go on your mortgage, it could be smarter to keep making the minimum payments to retain the tax advantages. As an alternative, consider the advantages of refinancing the remaining balance. At the reduced principal amount and with mortgage interest rates near historical lows, you may be able to reduce your monthly payments such that you can save nearly as much as you would if your mortgage were paid off. ❍❍❍

Make Saving a Habit

Habits are all about the principle of human inertia — we tend to keep doing what we've always done, and shy away from doing something new. The principle may work against you at first. If you're not used to saving money, it can be hard to get started. But once you gain some momentum with your new saving habits, it will be relatively easy to keep it up. Here are some tips:

Take full advantage of payroll saving plans. Payroll deduction is a great financial innovation. With one authorization form, you can start a savings program that works for you without any more effort on your part. It doesn't matter what type of plan it is or how much you put in. Just get started and you have a new habit.

Aim to max out your company match. When a company offers you a matching contribution, it's like they are saying, "Here's some free money. Want it?" Make sure you contribute enough to get the full matching contribution.

Treat saving as a bill. The old adage for saving is, "Pay yourself first." The trick is to treat saving like any other bill. Name an amount and a date to pay it, then make the payment when it comes due.

Set annual goals for account balances. You can never reach a goal if you don't have one. Specific annual targets for your account balances become incentives to save; and by dividing the difference between your current balance and your target, you can easily derive the periodic amount you need to contribute.

Devote your raises to saving. When you get a raise, don't forget to increase your savings. If you can afford to, bank the entire raise. If you can't do that, at least increase your savings by a portion of the raise.

Save your loose change. Keep a savings jar, and at the end of the week, put your loose change in it. You may also want to put bills below a specific denomination in the savings jar. At the end of the month, deposit the money in savings.

Saving is all about discipline — denying yourself immediate gratification in favor of securing your future. The tips above can take some of the pain out of creating a new habit or adjusting an existing one to help you pursue your goals.

What's Your Debt-to-Income Ratio?

It's common knowledge that lenders use your credit score (a mathematical calculation based on information on your credit report) when making lending decisions. But lenders also like to review your debt-to-income ratio.

To calculate your debt-to-income ratio, add up all your monthly debt obligations, including your mortgage, home-equity loans, auto loans, student loans, minimum credit card payments, and other debts. Divide that number by your monthly gross income to find your debt-to-income ratio.

To be considered a good candidate for debt, that number should generally fall below 36%. Go much higher than that and you are likely to have trouble getting additional debt or debt will carry higher interest rates or significant fees.

Lenders review both your credit score and your debt-to-income ratio, because your credit score is simply a reflection of your past payment history and does not indicate how much debt you carry in relation to your income.

Financial Thoughts

In a recent survey, fears about retirement savings were highest among individuals in their late 30s and early 40s. The survey found that nearly half (49%) of these individuals were "not too" or "not at all" confident about having enough to live on in retirement. In contrast, 39% of those age 55 to 64 and only 28% of those age 65 or older felt the same way. Over the past decade, this age group has lost the most wealth of any age group, with nearly all of those losses occurring since the Great Recession began in 2007. Median household wealth plunged 56% for this age group, from $99,727 in 2001 to $43,698 in 2010 (Source: Pew Research Group, 2012).

Nearly half of affluent investors expect today's economic uncertainty to not only continue, but to be more of a permanent reality (Source: *Merrill Lynch Affluent Insights Survey*, 2012).

The percentage of families who owned 401(k)-type plans increased from 31.6% in 1992 to 79.5% in 2007 to 82.1% in 2010. At the same time, the percentage of families owning an IRA or Keogh retirement plan decreased from 30.6% in 2007 to 28.0% in 2010 (Source: Employee Benefit Research Institute, 2012).