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financial SUCCESS

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What's Better: Saving or Paying Down Debt?

Debt can be dangerous to your financial health. Thus, 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 your age, 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 to 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 probably 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 income you and they count on. The bottom line: if you have debt, it may make sense to 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 a job loss or 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 might want to make.

You should make creating an emergency savings fund a priority. If you can't take care of priorities one and two while also paying for basic necessities, like groceries and gasoline, you're living beyond your means and should cut back on your spending.

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Dealing with a Spouse's Credit Issues

If one of you has an outstanding credit history and the other has credit problems, it can affect the approval process and the cost of your debt. Some tips to consider when one spouse has a poor credit history include:

✔ **Don't apply for joint credit.** If your spouse's credit history is very bad, it may pay to leave him/her off the credit application.

✔ **Ask a parent or relative to co-sign a major loan, such as a mortgage.** Before asking, keep in mind that you are asking that person to take responsibility for the entire loan.

✔ **Instead of applying for joint credit cards, list your spouse as an authorized user of your cards.** While an authorized user can charge on your credit card, you are responsible for paying the bills. If the account is paid promptly, it will be reported on both credit histories.

✔ **Use other strategies to improve your spouse's credit history.** Ensure your spouse makes all payments on a timely basis. Try to pay down as many of his/her credit balances as possible. If your spouse has difficulty obtaining credit, have him/her apply for a secured credit card. ❍❍❍

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What's Better?

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Third Priority: Retirement Savings

Finally, 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, if and 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 highest interest-rate debt.** 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 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 debt. If not, it's worth it to pay off 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 or older, the monthly cash flow you'd free up could be devoted to the extra $7,500 a year you can contribute, pretax, to a 401(k) plan in 2024. 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.

Smart debt management is often overlooked as a way to improve your finances, yet it can be as powerful as smart investment management. Please call your financial advisor if you'd like to discuss this in more detail. ❍❍❍

Your Retirement Portfolio and Bonds

Of the three main asset classes, bonds often appear the least exciting. However, bonds can be an important piece of any retirement portfolio, particularly as you age into your 40s and beyond. While there's never a one-size-fits-all rule when it comes to asset allocation, generally your bond allocation should increase as you near retirement.

When you're young, bonds will likely be of little importance to you. History shows that bond returns are typically lower on the aggregate than stocks, so an investor who's 30-50 years away from retirement might be understandably less interested in bonds. Investing predominantly in bonds in your youth might keep you from some panicked moments during temporary bear markets. But depending on your tolerance to a few downturns throughout the course of your working life, stocks' average return rate has historically been higher than that of bonds.

As you move closer to retirement, however, your vulnerability to risk increases, as you no longer have as much time to ride out a sudden stock decline. Increasing your bond allocation as you age can offer a buffer should you encounter a sharp decline in stocks. Keep in mind, however, that some of the age-based bond-to-stock ratio investment theories you've heard could be outdated guidance. Considering modern-day realities, along with the likelihood that you'll live a longer life than your parents or grandparents, it may not be as prudent to increase your bond investments at your exact aging rate.

Of course, your retirement portfolio should align with your individual retirement goals and risk tolerance, which is why stock and bond allocations often vary from person to person even within the same age category. While bonds, like any investment, come with a modicum of uncertainty, they typically carry less risk than stocks. Therefore, a more conservative investor, regardless of age, might choose a larger portion of his/her asset allocation to represent bonds. On the other hand, because stocks outperform bonds when it comes to long-term growth, a younger, more aggressive investor might choose to start out with no bond investments at all, focusing on stocks until retirement is more visibly on the horizon.

If you would like to discuss this topic in more detail, please call your financial advisor. ❍❍❍

Managing Investment Risk

Risk — the possibility of losing money — is one of the most feared words in investing. So what gives some people the ability to control their emotions and make cool and calm decisions? Two main reasons are that they know how to measure risk and how to manage it.

Two Ways of Measuring Risk

Beta — Professionals have two common ways to measure risk. The first is beta, which is how closely a portfolio's performance matches or varies from that of a benchmark index. The benchmark for large-company U.S.-traded stocks is the S&P 500 stock index, while a general benchmark for bonds of medium-range maturity is the Barclay's Aggregate Bond index. The performance of indexes is normally expressed as a percentage and reflects their total return, which is a combination of any interest or dividend payments and their change in price.

Beta is expressed as a number on an open-ended scale, and it can be a positive number, a negative number, or zero. A beta of 1.0 means a stock or portfolio's returns are identical in both size and direction to the benchmark, while a beta of -2.0 means the portfolio's returns are twice as large in the *opposite* direction of the index. For example, when the S&P 500 index return is 12%, a portfolio with a beta of 1.0 should also return 12%, while a stock with a beta of -2.0 should lose 24%. A beta of 0.0 means there is no patterned relationship between the two returns.

Standard deviation — A second way professionals measure investment risk is with standard deviation. Expressed as a percentage, it reflects a range of returns above and below an annual average rate of return for the stock or portfolio itself, without reference to a benchmark. It's standard deviation that measures the way many define risk: volatility.

In statistics, when applied to investment returns, one standard deviation covers about two-thirds of all returns. So a portfolio that has an average rate of return of 9% and a standard deviation of 12% means that in six to seven years out of 10, the portfolio's returns range between -3% and 21%. In general, a lower standard deviation is better, because it reflects less chance of a negative return.

Techniques to Manage Risk

Individual investors can use several methods to help reduce the risk and volatility in their portfolios:

✔ **Diversification.** The fewer the number of securities you own in your portfolio, the greater the risk that one or more will produce losses that reduce your ability to generate positive compound returns. In a stock portfolio, that usually means owning stocks of at least 10 different companies from at least five different sectors (such as, but not limited to, technology, consumer staples, finance, energy, and basic materials).

✔ **Asset allocation.** This refers to spreading your investments over the three classic asset classes (stocks, bonds, and cash) according to a formula that potentially matches the rate of return you need to meet your goals. The formula determines what percentage of your holdings should be from each asset class (e.g., 70% stocks, 25% bonds, and 5% cash). Because bonds and cash generate more steady (if smaller) average returns than stocks, the more of each included in your portfolio, the less volatile your overall returns should be.

✔ **Dollar cost averaging.** This is a technique that puts price declines to your advantage. It involves making periodic purchases in the same dollar amount of the same securities, in good markets and bad. When you continue to buy shares when their prices fall, you buy more shares than when the prices are higher. This gives you more shares, which increases your dollar gains when prices start going back up. However, it neither guarantees a profit nor protects against loss in a prolonged declining market. Because dollar cost averaging involves continuous investment regardless of fluctuating price levels, investors should carefully consider their financial ability to continue investment through periods of low prices.

✔ **Portfolio rebalancing.** This is a two-step process by which you restore your holdings to the proportions defined by your asset allocation strategy. The first step is to sell a portion of the investments in those asset classes where your holdings have grown to be larger than their prescribed percentage. The second step is to use the sale proceeds to buy more of the securities from those asset classes whose proportions have become too small. This provides a benefit similar to that obtained by dollar cost averaging.

Managing risk isn't about avoiding all losses, since they are an inevitable part of the investment process. Instead, it's about minimizing your losses while achieving the rate of return you need to reach your financial goals. ❍❍❍

Keep Saving after Retirement

Just because you're retired doesn't mean you should stop saving. Carefully managing your money and looking for ways to save will help ensure you remain financially fit during retirement. Consider these tips:

✔ **Construct a financial plan.** Most retirees fear they'll run out of money during retirement. To ease those fears, create a financial plan detailing how much money will be obtained from what sources and how that income will be spent. Make sure your annual withdrawal amount won't cause you to deplete your savings. Review your plan annually to ensure you stay on course.

✔ **Consider part-time employment.** Especially if you retire at a relatively young age, you might want to work on at least a part-time basis. Even earning a modest amount can help significantly with retirement expenses. However, if you receive Social Security benefits and are between the ages of 62 and full retirement age, you will lose $1 of benefits for every $2 of earnings above $22,320 in 2024. You might want to keep your income below that threshold or delay Social Security benefits until later in retirement.

✔ **Contribute to your 401(k) plan or individual retirement account (IRA).** If you work after retirement, put some of your earnings into a 401(k) plan or IRA. As long as you have earned income and meet the eligibility requirements, you can contribute to these plans.

✔ **Try before you buy.** Want to relocate to another city or purchase a recreational vehicle to travel around the country? Before you buy a home in an unfamiliar city or purchase an expensive recreational vehicle, try renting first.

✔ **Keep debt to a minimum.** Most consumer loans and credit cards charge high interest rates that aren't tax deductible. During retirement, that can put a serious strain on your finances. If you can't pay cash, avoid the purchase.

✔ **Look for deals.** Take the time to shop wisely, not just at stores, but for all purchases. When was the last time you compared prices for auto or home insurance? Can you find a credit card with lower fees and interest rates? When did you last refinance your mortgage? ❍❍❍

Watch Your Credit When Divorcing

Make sure to consider your credit accounts if you are going through a divorce. First, determine what types of credit accounts you have:

✔ An individual account is the responsibility of the account holder. The spouse is typically not responsible for any of this debt.

✔ Even if you have an individual account, you may have authorized your spouse to be an account user. Even though your spouse can charge on the account, you are solely responsible for the debt.

✔ A joint account is the responsibility of both spouses.

The divorce decree will typically indicate who is responsible for joint debts. However, if that person does not pay the debt, the lender can come after the other spouse.

Once your divorce is final, you might want to close any joint accounts or individual accounts where your spouse is an authorized user. You can also ask the creditor to convert a joint account to an individual account or remove your spouse as an authorized user. In some cases, the lender may have you reapply for credit before converting a joint account to an individual account. ❍❍❍

Financial Thoughts

Around three in four (74%) U.S. adults have a financial regret. Most commonly, Americans regret not saving for retirement early enough (21%), taking on too much credit card debt (15%), or not saving enough for emergency expenses (14%). About 48% of U.S. adults with at least one financial regret say their stress level over their top financial regret has increased in the past year, four times as many people as the 12% who say their stress level has decreased (Source: Bankrate, July 19, 2023).

For the 10th year in a row, child care costs have continued to rise. Today, families are spending, on average, 27% of their household income on child care expenses. And 59% of parents surveyed said they are planning to spend more than $18,000 per child on child care in 2023 (Source: *Cost of Care Survey*, 2023).

Back in 1983, 20.1% of workers were part of a union. In 2022, only 10.1% were (Source: U.S. Bureau of Labor Statistics, 2023).

Across the country, the share of car buyers who financed a vehicle with a monthly payment of at least $1,000 jumped to a record 17.1% in 2023. In 2019, it was just 4.3% (Source: Edmunds, 2023). ❍❍❍

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