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Financial Briefs

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Which Is 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 correct 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 income you and they count on. The bottom line: if you have debt, make the minimum payments until you're properly insured and 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

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Debt and Your Retirement

Most people's vision of retirement not only involves freedom from work but also freedom from debt. A debt-free retirement is a laudable goal, but it's one that has become increasingly difficult for many to achieve.

Mortgage, credit card debt — even student loans — now follow people into their golden years, and that can have serious consequences for their long-term financial health.

The Debt-Free Retirement Goal

When you retire, you stop actively earning income and start living on your savings. If you're still paying off debt, those payments will be another fixed expense, which means you'll have to draw more from your nest egg and have less to spend on things you truly enjoy. By going into retirement debt free, you'll lower your living expenses, which will make that nest egg last longer.

Reducing Debt before Retirement

If at all possible, you'll want to eliminate debt before you retire. Of course, some types of debt are worse than others.

High-interest credit card debt can be a significant burden, so you'll want to eliminate it as quickly as possible. Look for areas in your budget where you can cut back, or consider a second job and make extra debt payments.

If you have a car loan and are close to retirement, consider selling the car after you quit working, since many people find they no longer need multiple vehicles in retirement.

Getting debt-free before retirement may mean aligning your mortgage payoff date with your retirement date; you may be able to bring your mortgage payoff date closer by making extra payments.

Often, retirees want the peace of mind that comes with knowing they'll own their home when they retire. But that accelerated payoff plan might not be right for everyone. If you have a relatively low-interest mortgage, no other debt,

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Which Is Better?

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three to six months of your income. Not only does this give you breathing room from 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 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 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 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 $5,000 a year you can contribute pretax to an IRA or 401(k) plan. 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 a reduced principal amount and with mortgage interest rates near historic lows, you may be able to reduce your monthly payments so that you can save nearly as much as you would if your mortgage was paid off.

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 if you'd like to discuss this in more detail.

Borrow Wisely

- Use debt only for items that have the potential to increase in value, such as a home, college education, or home remodeling. Avoid incurring debt on items like clothing, vacations, or other luxuries.
- Consider a shorter term when applying for loans. Even though your monthly payment will be higher, you will incur much less interest over the life of the loan.
- Make as large a down payment as you can afford. If you can make prepayments without incurring a penalty, this can also significantly reduce the interest paid.
- Consolidate high-interest-rate debts with lower-rate options. It is typically fairly easy to transfer balances from higher-rate to lower-rate credit cards. Another option is to obtain a home-equity loan to pay off consumer debt. In many cases, home-equity loan interest rates are lower than other forms of personal loans; and as long as the home-equity loan balance does not exceed $100,000, interest payments are tax deductible.
- Compare loan terms with several lenders, since interest rates can vary significantly. Negotiate with the lender. Although most lenders have official rates for each type of loan, you can often convince them to give you a lower rate if you are a current customer or have outstanding credit. Review all your debt periodically, including mortgage, home-equity, auto, and credit card debt, to see if less-expensive options are available.
- Review your credit report before applying for a loan. You then have an opportunity to correct any errors that might be on the report.

Debt

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and are already maxing out your retirement savings, you may feel comfortable sticking with your standard repayment plan, especially if you can get more from investing the money you'd otherwise use to make extra mortgage payments.

One thing you shouldn't do: take money out of your retirement accounts to pay off credit card or mortgage debt. If you focus all your financial resources on paying off your loans, you run the risk of retiring with inadequate savings. Another potential misstep: prioritizing debt payoff over saving. While you don't want to be saddled with excessive debt, you also don't want to end up cash poor in retirement, without enough money to meet everyday expenses.

Debt in Retirement

Unfortunately, many people still end up nearing retirement holding a significant amount of debt. If that's your situation, you have several options. One is to delay retirement for a few years while you concentrate on paying off debt. Plus, if you continue to work, you're not tapping your nest egg and it can continue to grow. In addition, if you delay claiming Social Security, your monthly payment will increase by up to 8% a year until you reach age 70.

If you must enter retirement with debt, you may need to pare down your lifestyle — traveling less frequently, moving to a smaller home, or giving up your boat or RV — to reduce debt and minimize the risk of outliving your retirement savings.

You could also continue to work part-time or as a consultant. That can bring in extra income, and many people enjoy a more gradual transition to full retirement.

Finally, know that going into retirement with debt poses some other specific risks. While most creditors can't garnish your Social Security payments, the federal government is an exception.

If you owe back taxes, student loans, alimony, child support, or certain other types of payments, you may lose up to 15% of your Social Security benefits.

Interested in learning more about what you can do to retire debt before you retire? Please call if you'd like to discuss this in more detail.

How to Avoid Credit Card Dependence

As of the end of 2016, the total average household debt was over $132,000, which has significantly increased from 2002, when it was just over $88,000. Over the past 13 years, income has grown by 28%, while the cost of living has increased by 30% in that same time period (Source: *CNBC*, December 13, 2016).

The discrepancy between the cost of living and income has led Americans to rely more on credit cards. Approximately 70% of Americans have a least one credit card (Source: *creditcard.com*, October 25, 2016), with an average credit card balance of over $16,000. With the average credit card interest rate at 18.76%, the average household is paying almost $1,300 in interest each year (Source: *CNBC*, December 13, 2016).

Are You Credit Card Dependent?

Ask yourself these questions to evaluate your dependence on credit cards:

- Do you rely on credit cards to make it through until your next paycheck?
- Does it seem you always have to put unexpected expenses on your credit card?
- Do you think you spend more than you would with cash because your card has rewards or discounts?
- Do the holidays leave you with a mountain of credit card debt?

If you answered yes to these questions, you are probably relying too much on your credit cards. If you are concerned that you are too dependent on your credit cards, there are steps you can take to become credit card independent.

- Put your credit cards somewhere for safekeeping to reduce the temptation to use them as your regular form of payment.
- Become more disciplined with spending by enacting a cash-only policy. While many people use debit cards as a convenient way to pay cash; be careful, because many financial institutions will allow you to overdraft your account when you use a debit card and may charge a large fee for this overdraft privilege.
- Consolidate your balances to fewer cards that have the lowest interest rates and close the rest of your credit card accounts to reduce the amount of available credit and, thus, the potential amount of debt you could incur. While closing credit cards can have a negative impact on your credit score, it's still better to have a temporary credit score setback than to go deeper into debt if you can't control your spending. To reduce the impact to your score, you should also consider keeping your oldest credit card in addition to a lower interest-rate card.
- Shock yourself into reality by looking at a few important things on your credit card statement including: how much you are paying in interest on an annual basis, how long it will take to pay off the balance, and how much you will pay in interest if you are only making the minimum monthly payment. This information can be a real eye-opener.

Please call if you'd like to discuss this in more detail.

Business Data

Indicator	Month-end Aug-17	Sep-17	Oct-17	Dec-16	Oct-16
Prime rate	4.25	4.25	4.25	3.75	3.50
3-month T-bill yield	1.02	1.05	1.02	0.56	0.35
10-year T-note yield	2.22	2.26	2.33	2.55	1.76
20-year T-bond yield	2.57	2.57	2.61	2.86	2.17
Dow Jones Corp.	2.95	2.97	3.08	3.17	2.76
GDP (adj. annual rate)#	+1.20	+3.10	+3.00	+2.10	+3.50

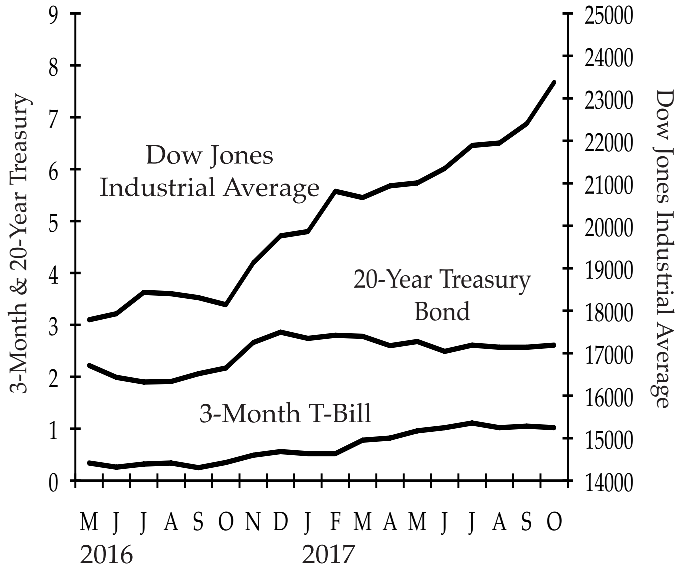
Indicator	Month-end Aug-17	Sep-17	Oct-17	% Change YTD	12-Mon.
Dow Jones Industrials	21948.10	22405.09	23377.24	18.3%	28.9%
Standard & Poor's 500	2471.65	2519.36	2575.26	15.0%	21.1%
Nasdaq Composite	6428.66	6495.96	6727.67	25.0%	29.6%
Gold	1311.75	1283.10	1270.15	9.6%	-0.1%
Unemployment rate@	4.30	4.40	4.20	-8.7%	-16.0%
Consumer price index@	244.80	245.50	246.80	2.2%	2.2%
Index of leading ind.@	128.30	128.80	128.60	3.7%	3.4%

— 1st, 2nd, 3rd quarter @ — Jul, Aug, Sep Sources: *Barron's, Wall Street Journal*

Past performance is not a guarantee of future results.

18-Month Summary of Dow Jones Industrial Average, 3-Month T-Bill & 20-Year Treasury Bond Yield

May 2016 to October 2017



News and Announcements

Set Your Own Debt Limits

Credit can be a valuable tool that allows you to purchase major items and pay for them over time. But the ready availability of credit also makes it easy to incur more debt than you can comfortably repay. Rather than allowing lenders to set credit limits for you, evaluate your financial situation and determine your own limits.

To find out where you stand with consumer debt, which includes all debt except your mortgage, make a list of your debts and monthly payments. Then calculate your debt-to-income ratio by dividing your monthly debt payments by your monthly net income. The general guideline is that your debt-to-income ratio should not exceed 10% to 15% of your net income, with 20% usually considered the absolute maximum. However, you should consider your own circumstances and decide how much debt you are comfortable with.

Before purchasing something on credit, carefully evaluate whether it makes financial sense to do so. Some questions to ask yourself include:

- Should I wait and save the money so I can pay cash for the item?
- Will the cost of the item increase or decrease in the future?
- Is it really worth paying interest on the item so I can use it now?
- Will I still be within my designated debt limits if I add this new debt payment?
- Will the item still have value after I finish paying for it?

Setting your own debt limit and carefully evaluating whether you should purchase an item on credit should help you keep your debt under control.

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