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Financial Briefs

MAY/JUNE 2013

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. For some, those who lost their jobs and ran out of savings, it was a lesson relearned the hard way. But for those who have managed to hang on or were young and had low levels of debt, it raises the question: 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 investment 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 should you want to change jobs.

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,

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Are Americans Saving Enough?

If there was one bright side to the Great Recession, it was that Americans started saving more of their money than they had in a long time. But now that the economy is showing reluctant signs of getting stronger, we're back to less savings.

As of the end of November 2012, Americans were saving just 3.6% of their disposable income (Source: The St Louis Federal Reserve, 2013). As low as that may be, it's better than the first 10 years of the 21st century, when we put away an average of just 3.3% of our disposable income. We actually hit a low of just 0.9% in October 2001, and by the middle of the decade, observers declared that America was experiencing a "savings crisis."

In response to the stock and real estate market meltdowns, which began in 2006 and 2007 respectively, Americans started borrowing less and saving more. The savings rate peaked at 8.3% in May 2008, but has been making a jagged line lower since then.

The pattern was in line with a trend toward lower savings rates for at least the last 40 years. In the 1970s, we saved an average of 10.3%. In the 1980s, that fell to 8.6%, and in the 1990s, the rate dropped to 6.1%.

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What's Better?

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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 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 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.

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.

Teaching Children to Handle Credit Cards

Credit cards can be a great convenience for both college students and their parents. They reduce the need to carry cash; enable students to purchase books, clothing, and other incidentals; and provide a ready source for emergency funds. There is another advantage — students who handle their credit cards responsibly have a head start on establishing a good credit history.

However, young adults can't always be counted on to exercise caution when it comes to spending money. And a virtual blank check, in the form of a student's own credit card or authorized use on your card, can often be an irresistible temptation. For a student using a parent's card, the risk may come in the form of a hefty unexpected bill that cuts into monthly cash flow or reserves. But for a student with his/her own card, the risks are even more far reaching: over-limit fees, late fees, and missed payments that can damage the student's credit rating.

So what's a parent to do? While you probably can't stop your college student from getting a credit card, you can help teach him/her to use that card responsibly. Consider the following tips to help your child manage credit responsibly:

- **Help your child select a credit card.** Try to convince your child to use a debit card instead of a credit card, so he/she won't get into debt. If your child insists on using a credit card, go through several offers with him/her, comparing interest rates, annual fees, grace periods, and penalties.
- **Explain the basics of credit card debt.** Make sure your child understands that not paying the balance in full every month can result in a significant amount of interest. Low minimum payments mean it may take years to pay off credit card balances. Try to instill the concept of paying credit card balances in full every month.
- **Urge your child to only use credit cards for necessities, not to fund luxuries.** Credit cards can be used for items like book purchases and car repairs, but they should be avoided for clothing, dining out, and entertainment, unless your child can pay the balance in full every month.
- **Go over your child's credit card statement every month.** Show your child how to compare receipts to credit card statements. Go over all purchases and explain how credit cards can increase impulse purchases.

Are Americans Saving?

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What's at Stake: Retirement

If it didn't matter how much we saved, these would simply be numbers of interest to economists. But in fact, many argue that the long-term strength of the American economy depends on how much we all save — so we have funds available for investment in future growth. On a personal level, what matters is how many of us are well prepared for retirement. And on that score, the numbers are both scary and sad.

First, the scary part:

- Forty-six percent of all Americans die with less than $10,000 — "virtually no financial assets" — according to a recent study by economists at Harvard, Dartmouth, and MIT (Source: *Huffington Post*, August 6, 2012).
- The Life Insurance Marketing and Research Association reported in November 2012 that nearly half of all Americans aren't contributing to a retirement plan.
- Fidelity Investments, the nation's largest administrator of retirement funds, said that the average amount in its customers' retirement accounts was just $72,000.
- A Congressional study released this summer said that there's a $6.6 trillion gap between how much Americans should have on hand for a comfortable retirement and how much they actually have.

Now the sad part: A survey released this year by the Pew Charitable Trust found that two-thirds of us believe we are saving enough for retirement.

How Much Is Enough?

Fidelity Investments offers these guidelines for judging whether you're well on your way to a comfortable retirement: "A 40-year-old…should have around two times his or her annual salary; a 45-year-old should have three times his or her salary in savings; a 50-year-old, four times; and so on, with the goal of having at least eight times your annual salary (ideally more) socked away by the time you retire. That final target suggests that someone making $80,000 a year should have $640,000 saved for retirement, supplemented by other sources like Social Security. That yields enough cash to live on about 85% of their former salary."

But advisors at T. Rowe Price argue that when you're ready to retire, you should have 12.5 times your last year's income saved. For someone making $100,000 a year, that comes to $1.25 million. Invested at an average annual rate of return of 7% and a withdrawal rate of 4% a year, that would produce income of about $50,000 a year for life, adjusted for inflation. With about $25,000 a year coming from Social Security, that would meet the goal of living on 70% to 80% of your income in retirement.

Are You Saving Enough?

General rules of thumb are fine, but every individual's situation is different. Thus, everyone needs an individualized retirement savings plan. Studies show that those who have an investment plan that's updated every few years are the most likely to meet their retirement goals. If you have to create a plan or haven't updated yours recently, please call.

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. If you haven't started saving or aren't saving enough, 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.

Business Data

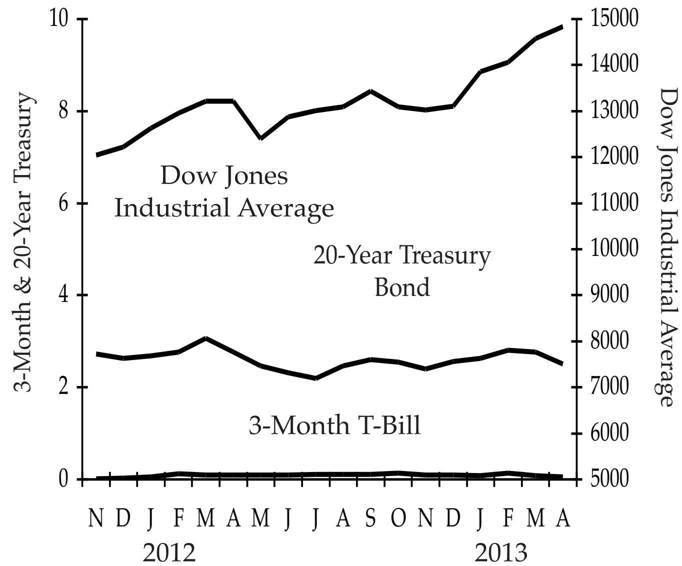
Indicator	Feb-13	Mar-13	Apr-13	Dec-12	Apr-12
	Month-end				
Prime rate	3.25	3.25	3.25	3.25	3.25
3-month T-bill yield	0.13	0.08	0.05	0.09	0.09
10-year T-note yield	2.01	1.94	1.73	1.80	2.00
20-year T-bond yield	2.81	2.77	2.51	2.56	2.76
Dow Jones Corp.	2.61	2.58	2.44	2.70	3.21
GDP (adj. annual rate)#	+3.10	+0.40	+2.50	+0.40	+1.90

Indicator	Month-end Feb-13	Month-end Mar-13	Month-end Apr-13	% Change YTD	% Change 12 Mon.
Dow Jones Industrials	14054.49	14578.54	14839.80	13.2%	12.3%
Standard & Poor's 500	1514.68	1569.19	1597.57	12.0%	14.3%
Nasdaq Composite	3160.19	3267.52	3328.79	10.2%	9.3%
Gold	1588.50	1598.25	1469.00	-11.6%	-11.0%
Unemployment rate@	7.90	7.70	7.60	-2.6%	-7.3%
Consumer price index@	230.30	232.70	232.80	1.1%	1.5%
Index of leading ind.@	94.30	94.80	94.70	1.4%	-0.9%

— 3rd, 4th, 1st quarter @ — Jan, Feb, Mar 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

November 2011 to April 2013



News and Announcements

Set Your Own Debt Limit

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 mortgage debt, make a list of your debts and monthly payments. Then calculate your debt ratio by dividing your monthly debt payments by your monthly net income. The general guideline is that your debt 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.

FR2013-0122-0517