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the FINANCIAL INSIGHTS

UPDATE

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Paying Off Debt Isn't Saving

Should you save your money or pay off debt? It probably comes as no surprise to hear that it depends. But one thing is certain: paying off debt is *not* the same as saving. Here's why.

The rational objective for all sound financial planning is to increase your net worth, which is the true measure of your financial health. Calculating your net worth is simple: total up the value of everything you own, and subtract from that all of your debt.

Net Worth = Assets – Debt

Paying off debt almost always improves one aspect of your financial wellbeing: it lowers your monthly bills, which means you can either spend or save more. But if you look carefully at the formula for net worth, it's clear that paying off debt doesn't immediately increase your net worth, because it reduces your assets by as much as it reduces your debt. So, by itself, paying off debt doesn't do anything to advance your goal of building your wealth. It only helps if you save the amount you no longer have to send to your creditor.

Higher Priorities Should Come First

Paying off debt can also make your financial situation more precarious. For example, if you deplete your savings to pay off debt, you may be in a worse position to cover your expenses in the event of an emergency. In fact, it's one of the principles of good planning to maintain an emergency savings account equal in value to three to six months of your living expenses. So unless you already have enough tucked away in your emergency fund, you should consider if it makes sense to use any free cash to pay off a debt. And if you have a partner and

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Dealing with a Spouse's Credit Issues

Combining your finances with your spouse's finances may also include combining your credit histories. When you apply jointly for debt, both your credit histories will be evaluated. Thus, 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. If you default, the lender can come after your co-signer.

✔ **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, helping to improve your spouse's credit history. However, if you make delinquent payments, only your credit history suffers, since your spouse can ask to be removed from the card.

✔ **Use other strategies to improve your spouse's credit history.** Ensure that 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. ✔✔✔

Paying Off Debt

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dependent children, maintaining a life insurance policy sufficient to meet their needs should also be a higher priority than paying off debt.

But let's say you have both of these objectives covered. Does it make sense to be aggressive in paying off your debts? It can. It generally (but not always) comes down to comparing the potential return on your investing choices to the *effective* interest rates you're being charged on your loan.

Compare interest rates. If you're paying a higher rate of interest on a debt than you could earn on an investment, it makes sense to pay off that debt as quickly as you can. Such is typically the case with credit cards, where it's rare the interest rate is less than double digits. Making only the minimum required payment is generally a bad idea, because interest and fees can grow faster than you pay down the principal. At the very least, then, you should try to pay more than the minimum — even if you're not trying to be aggressive in paying down the balance.

If you have money left over at the end of the month, you should consider both trying to save and paying down your debt at the same time. This is especially true when it comes to tax-advantaged savings plans, like individual retirement accounts (IRAs) and 401(k) plans. Contributions to these are often made on a pre-tax basis, which adds to the effective total return you receive. If your employer matches your contributions, you should do all you can to contribute to the maximum match before taking an aggressive stance toward reducing your debt load.

Don't forget the power of compounding. The biggest reason to save *and* pay down debt at the same time is that saving, even relatively small amounts, puts time on your side by harnessing the power of compounding. When you reinvest your returns — whether it's interest, dividends, or capital gains — your money makes more money, and you can reach your long-term goals faster.

Be careful about paying off mortgages. Owning a home free of mortgage debt remains a fond dream that influences many Americans' decisions. It explains why 15-year mortgages seem more appealing to some than 30-year mortgages: not only are the interest rates for 15-year mortgages generally lower, but it takes less time to pay them off, and the accumulated interest you pay is much less.

But it's not necessarily a smart idea to take out a 15-year mortgage because the required monthly payments are generally 20% to 30% higher than the payment on the same principal amount for a 30-year loan. That means you have less free cash flow to devote to saving in a retirement plan, and if you lose your income for an extended period of time, it's harder to keep up with the payments.

On top of that, mortgage interest is generally tax-deductible. Finally, the interest rates on mortgages are among the lowest consumers face. All of this means that paying off a mortgage more aggressively is one of the last things you should consider doing with your money.

In summary, paying off debt has its advantages, but whether it's the right thing for you depends on your broader financial picture, what kinds of debts you have, what interest rates they carry, and what your saving opportunities are. It can take some careful analysis to make the best decisions. Please call if you'd like to discuss this in more detail. ✔✔✔

Avoid Cosigning a Loan

To keep your credit rating high, avoid cosigning a loan for someone else. This can be difficult to enforce, since the request typically comes from a family member or friend. However, the reason this favor is typically needed is to satisfy a creditor who does not consider the person a good credit risk and wants additional assurance before granting the loan.

When you cosign a loan, you sign a legal document accepting responsibility for the entire debt. If the primary borrower falls behind in payments, the creditor can come to you immediately looking for payment. The creditor does not have to first exhaust legal remedies with the primary borrower.

Additionally, the primary borrower's late payment history is likely to appear on your credit report. The debt is also listed as your debt on your credit report, which may impair your ability to obtain another loan.

If you are a cosigner on a loan that the primary borrower can't repay, call the creditor immediately and try to negotiate. The creditor may agree to settle for a lesser amount to avoid legal or collection fees. But make sure the creditor agrees to keep your credit report clean for that lesser amount. When the debt is paid, review your credit report to make sure it is reported correctly. ✔✔✔

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 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.

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%.

Techniques to Manage Risk

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

✔ **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 generally means owning stocks of at least 10 different companies from at least five different sectors.

✔ **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. 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.

✔ **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. 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 and normal 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.

Please call if you need help aligning your investment strategy with your goals while adapting to changing market trends. ✔✔✔

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.

Market Data

	Month End			% Change	
Stocks:	Nov 23	Oct 23	Sep 23	YTD	12-Mon.
Dow Jones Ind.	35950.89	33052.87	33507.50	8.5%	3.9%
S&P 500	4567.80	4193.80	4288.05	19.0	12.0
Nasdaq Comp.	14226.22	12851.24	13219.32	35.9	24.1
Total Stock Market	45414.79	41597.35	42788.69	17.9	10.8
Precious Metals:					
Gold	2035.45	1996.90	1870.50	12.3	16.1
Silver	25.26	23.13	22.35	6.4	16.6
Interest Rates:	Nov 23	Oct 23	Sep 23	Dec 22	Nov 22
Prime rate	8.50	8.50	8.50	7.50	7.00
Money market rate	0.47	0.61	0.48	0.33	0.31
3-month T-bill rate	5.28	5.33	5.33	4.35	4.29
20-year T-bond rate	4.72	5.21	4.92	4.14	4.00
Dow Jones Corp.	5.83	6.34	6.08	5.54	5.46
Bond Buyer Muni	4.94	5.29	4.96	4.64	4.82

Sources: Barron's, Wall Street Journal. An investor may not invest directly in an index.

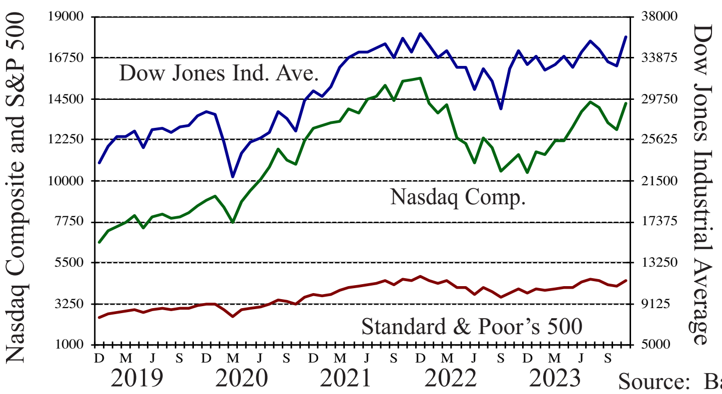
Rather than allowing lenders to set credit limits for you, evaluate your financial situation and determine your own limits.

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 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? ✔✔✔

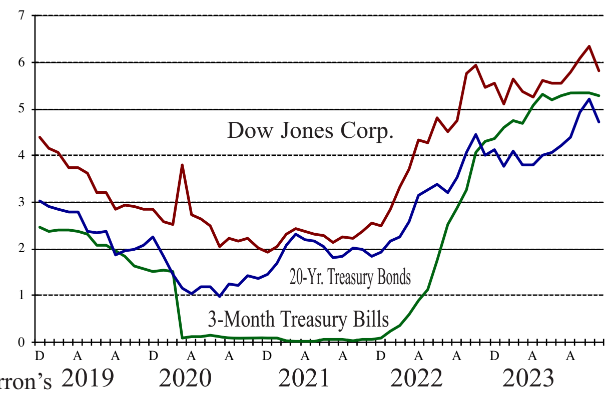
Stock Indices

December 2018 to November 2023



Interest Rates

December 2018 to November 2023



Source: Barron's

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