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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.

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. 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 your 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 and make extra debt payments, or consider a second job to make extra 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.

Becoming 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, 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 that you'd otherwise use to make the extra mortgage payments.

One thing you shouldn't do: take

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Frankly Speaking

"Political power does not rest with those who cast votes; political power rests with those who count votes." -Joseph Stalin

THE SAME SCORE - Donald Trump beat Hillary Clinton 306 - 232 in the Electoral College in 2016, but then lost to Joe Biden 306 - 232 in the Electoral College in 2020 (Electoral College).

"The saddest aspect of life right now is that science gathers knowledge faster than society gathers wisdom." -Isaac Asimov

The dust has settled and as we approach the New Year, the ravages of the old one continues to vex us. Granted, markets seem to be reflecting a sense of exuberant well-being, but we all know that life isn't so copesetic and we are feeling the seeming relentless strain of Rona. So, what can we do? Certainly, continue with your financial plan, perhaps modify it a bit but do NOT abandon it. 'Follow the guidelines' staying socially distant, wear masks and distract yourself with physical activity like walks, (great if you have a dog), exercise, meditation, yoga and 'mindfulness' (look it up as I had to).

Realize that this too shall pass like the Tech Wreck; 9-11; the Debt Wreck; MERS; SARs - all of which seemed so terrible… for a while. Remember to say the prayer, "Lord grant me the serenity to accept the things I cannot change, courage to change the things I can, and the wisdom to know the difference". We have a vaccine now; all we need is a distribution method. ❍❍❍

Debt

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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 benefit.

Interested in learning more about what you can do to retire debt-free? Please call to discuss this in more detail. ❍❍❍

Financial Rules of Thumb

Financial rules of thumb are designed to provide quick guidelines for your finances. However, you shouldn't blindly follow them without giving thought to your personal circumstances. Some of the more common rules of thumb include:

Save 10% of your gross income. While this will give you a good start, it's typically the minimum, not the maximum, you should be saving. Analyze how much you'll need for your financial goals, and then work backwards to calculate how much you should be saving.

Plan on spending 80% of your preretirement income during retirement. This may be true if you don't plan to be very active during retirement, but more and more people expect retirement to include extensive travel and expensive hobbies. On the other hand, if you've paid off your mortgage and your children have finished college, you may need less than this. Review your individual situation to determine how much you'll need.

Set the percentage of stocks in your portfolio to 100 minus your age. With increased life expectancies, this can result in a portfolio that is too heavily weighted in income investments. Set your asset allocation based on your risk tolerance and time horizon for investing. Stocks should be considered for long-term financial goals of 10 years or more.

Keep three to six months of income in an emergency fund. While an emergency fund is a good idea, how much you keep in that fund will depend on your circumstances. You may need a larger fund if you are the sole wage earner in the family, work at a seasonal job, own your own business, or rely on commissions or bonuses. A smaller fund may be required if you have more than one source of income, can borrow significant sums quickly, or carry insurance to cover many emergencies.

Pay no more than 20% of your take-home pay toward short-term debt. Once considered a firm rule by lenders, you may now be able to obtain loans even if you exceed this amount. Try to reduce your debt or at least reduce the interest rates on your debt.

Keep your mortgage or rent payment to no more than 30% of your gross income. While you can obtain a mortgage for more than that, staying within this rule will help ensure you have money to devote to other financial goals.

Refinance your mortgage if interest rates decline by 2%. This rule of thumb assumes you'll pay significant refinancing costs, including points, title insurance, appraisal fees, and other fees. However, many lenders now offer refinancing deals with significantly lower costs. Thus, you should assess whether it makes sense to refinance when mortgage rates decline by as little as half a percent.

Obtain life insurance equal to six times your annual income. Different individuals require vastly different amounts of insurance, depending on whether one or both spouses work, minor children are part of the family, or insurance is being obtained for other needs, such as to fund a buy-sell agreement or to help pay estate taxes. Thus, you should determine your precise needs before purchasing insurance.

Most financial rules of thumb should not be followed without first considering your individual circumstances. Please call if you'd like to address your needs in any of these areas. ❍❍❍

How to Set Savings Goals

Setting clear, specific savings goals is one of the best ways to achieve your financial objectives, but it's a task that many people struggle with. Unfortunately, establishing savings goals is a bit more complex than simply picking a number out of the sky and hoping you can eventually set aside that much cash. Below is a simple seven-step plan that you can use to set — and reach — your savings goals.

1. Select Goals

Before you start saving, it helps to know what you are saving for, since most of us find it easier to save money if we know it will eventually be used for a specific purpose. Common savings goals are creating an emergency fund with at least six months of living expenses or saving for retirement, a child's college education, a down payment, or a vacation. Your goals will be as unique as you are; the most important thing is that you select them and make them as specific as possible.

2. Determine How Much You Need to Save

Exactly how much money do you need to accomplish your goal? For example, you may want to have $5,000 saved for your dream vacation, $30,000 for a down payment on your first home, or $1 million for retirement. Don't pick a random number at this point — research how much you'll actually need so you can be confident that your savings will be sufficient to achieve your goals.

3. Consider Your Timeline

Savings goals can generally be divided into three broad categories: short-term (those that you hope to reach in a year or less), mid-term (those that are roughly one to five years away) and long-term (goals you hope to achieve in five years or more). It's important to know your timeline, since it will have a direct impact on how aggressively you need to save to hit that target and where you put your money.

4. Determine How Much to Set Aside Each Week or Month

For short-term goals, this step is fairly simple. Say you plan to get married in a year, and you want to have $10,000 saved toward that goal before your big day. To meet that goal, you'll need to save roughly $833 per month for the next year, or $10,000 divided by 12.

Determining how much you need to save to hit your long- and mid-term goals can be a bit more complicated, as you'll need to take into account the growth of your investments.

Whatever the timeframe for your goals, making these calculations is important because it allows you to adjust your savings as your budget allows. For example, if you can't afford to save the over $800 a month you need for the wedding, you have two options: You can either adjust your timeline or opt to keep it the same and save less.

5. Automate Your Savings If Possible

Once you know how much you need to save, you'll likely find it easier to stick to your plan if you can automate your savings. Adopt the pay-yourself-first principle and set up automatic transfers to your savings or investment accounts. The key is to save the money before you ever have a chance to spend it, as well as to avoid forgetting to make the transfers.

6. Choose the Right Way to Save

Depending on your goals and timeline, you have different options for savings. Traditional savings accounts are a good option for short-term goals, since your money will be safe. Investment accounts and retirement accounts, like a 401(k) plan or IRA, are good options for longer term goals, since you'll earn money as you save.

7. Watch Your Money Grow

Once you have your savings plan in place, keep an eye on how it is doing. You will need to periodically review your results and make adjustments as necessary.

Please call if you'd like to discuss your savings goals in more detail. ❍❍❍

Long-Term Portfolio Management

If you're in the markets for the long haul and look to capture the benefits of long-term trends, you should focus on the tools that maximize your long-term rate of return while managing the risks you take:

Asset allocation. A long-term asset allocation strategy aims at determining an optimal mix of stocks, bonds, and cash equivalents in your portfolio to suit how much risk you're willing to take. The benefit of investing in all three asset classes is diversification — spreading investments among assets that have different cycles of return.

Portfolio rebalancing. This may be the most overlooked technique for potentially boosting returns and controlling risk. Yet the technique is relatively simple: once a year (or some other predetermined time period), compare the percentage of your assets in each class to your strategy. Then sell some assets from the categories that are larger than your strategy calls for and use the proceeds to buy more of the assets that decreased in value. The principle is that rebalancing forces you to sell high and buy low.

Dollar-cost averaging. This technique actually puts market downturns to work in your favor. The method is to invest a set amount of money on a recurring basis in each asset class. By continuing to make purchases when prices decline, you buy more shares than you do when prices are high. Keep in mind that dollar-cost averaging 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.

Between the strategies of trading actively and managing your portfolio strictly for the long term is a technique called tactical asset allocation. This involves moving significant chunks of your portfolio from one asset class to another, depending upon your reading of the changing prospects for risk and reward.

Trading involves market timing, which in turn depends on reading market and economic indicators with precision. Is watching the indicators for the right moment to move in a new direction the right approach for you?

To determine the approach right for you, please call. ❍❍❍

Borrow Wisely

✔ Use debt only for items that have the potential to increase in value, such as a home, college education, or home remodeling.

✔ Consider a shorter term when applying for loans.

✔ 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.

✔ 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 an outstanding credit score. 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. ❍❍❍

Financial Thoughts

Based on data from the Survey of Consumer Finances, older adults with more outstanding debt commonly respond to liquidity constraints by working longer, delaying retirement, and postponing claiming Social Security benefits. The researchers found that more household debt translates to an expectation of about an extra 2.5 months of full-time work and an additional year of overall work. Individuals with a negative net worth (or more debt than financial assets) work for an additional two years. The study determined that mortgage debt remains the most significant and common source of debt among older households, representing 69% of total debt in 2016. Older adults with a mortgage are 4.8% less likely to be retired and 3.1% less likely to receive Social Security benefits (Source: *AAII Journal*, June 2020).

Emerging research on cognitive aging found declines in financial capability and concurrent lower investment performance among older individuals. Investors older than 75 on average experience investment returns that are 3% lower than those of middle-age investors. The return disparity rises to 5% among older investors with greater wealth (Source: *AAII Journal*, July 2020). ❍❍❍