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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 many variables that are unique to an individual or family. These may include age, existing savings, when you plan to retire, what your debts and liabilities are, rates of interest on debts, and more. Following are some important considerations when planning for debt reduction and savings.

## First Priority: Insurance

Those who fail to plan, plan to fail. This adage rings true more often than one would like to believe when they don't adequately insure themselves against death, disability, or loss of income. Your first priority is to find appropriate policies with adequate coverage so that you can transfer these catastrophic risks off of you or your loved ones in case the unexpected happens.

If you're young, unmarried, and do not have significant assets yet compiled, having basic health insurance that covers catastrophic injuries may be adequate coverage for you. Those who have a family will likely need life insurance as well as short- and long-term disability insurance. If your employer provides these types of insurance, you may need to additionally insure if that coverage no longer provides enough support or the insurance is discontinued if you leave that job.

In each case, you're looking to provide yourself or your survivors with a replacement of income that you and they count on, in the case that you can no longer provide it yourself. The bottom line: Prioritizing debt repayment over adequate insurance coverage could be catastrophic for your family. Assess the costs of properly insuring against loss of life and income before addressing debt repayment. You may need to make minimum payments or smaller debt repayments than you would prefer at this time, but you will have transferred many detrimental risks off of you, which will support your financial wellness in the long term by shielding you from potentially catastrophic risks and the debts associated with them.

## 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 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

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## 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.
- ✔ 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 total 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.
- ✔ Compare loan terms with several lenders, since interest rates can vary significantly. Negotiate with the lender. Review all your debt periodically to find less-expensive options.
- ✔ Review your credit report before applying for a loan, so you have an opportunity to correct any errors. ❍❍❍

## Which is Better?

*Continued from page 1*

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 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 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, 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; however, for better understanding, you should discuss what is deductible under the new tax provisions with your tax professional.

✔ **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 the interest rate you are being charged, consider investing your extra money instead of using it for paying off debt. One must balance that risk of reward compared to the assurance of paying 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. Talk with a qualified financial planner such as a CERTIFIED FINANCIAL PLANNER™ professional to assess the cost-benefit analyses of investing in financial markets for higher earnings versus paying off debt. 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.

Smart debt management is often overlooked as a way to improve your finances. Use us as a resource as you review your debts and saving strategies. We're here to help. ❍❍❍

## How to Protect Against Medical Identity Theft

While we've become accustomed to hearing about hacking of personal data at large retailers, the medical industry is fast becoming the industry at the highest risk of data hacking — 91% of healthcare organizations experienced a data breach in the past two years (Source: *Forbes*, May 29, 2015).

The consequences of these data breaches can range from financial to medical fraud. Medical records typically contain payment information such as credit card numbers, but also carry data like Social Security numbers and insurance information, which can enable a criminal to obtain medical services and payments under another's identity.

There are several reasons the healthcare industry has become a new target for hackers. First, the American Recovery and Reinvestment Act of 2009 and the Affordable Care Act in 2010 required health care organizations to digitize their health information. Second, because most information was previously held in hard copy form, the healthcare industry has not been as savvy about data protection. These two things opened up a whole new world for cybercriminals. Finally, healthcare information commands a much higher price on the black market. An FBI report shows that health insurance information has a $60 to $70 price tag compared to $1 for a Social Security number (Source: *Forbes*, May 29, 2015).

Cybercriminals profit from healthcare data by getting healthcare for themselves or selling it to someone who is uninsured and in need of medical care. But the big profit comes from private health insurance, Medicare, and Medicaid fraud. For example, for every Medicare or Medicaid number stolen, individuals can bill the government for services and equipment as well as prescription medicines.

### How to Protect Your Information

While the healthcare industry is making strides in data protection, you should be diligent about protecting your medical information. Following are some steps you can take:

- Ask your physician for a copy of your medical records so you can review them for accuracy. You'll want to make sure your medical history, prescribed treatments, allergies, blood type, etc., are accurate, so that if you are in an emergency situation, you're not receiving treatment that could be detrimental.
- Take time to review the Explanation of Benefits you receive from your insurance company. This is the best document to review to uncover medical fraud.
- If your physician or a hospital is asking you to provide your Social Security number, find out why they need it and make sure it is absolutely necessary.
- Monitor your credit report on a regular basis to ensure that you don't see activity that is the result of stolen payment information.
- Consider a medical identity monitoring service, which will identify all healthcare transactions on your account. ❍❍❍

# Assessing Your Risk Tolerance

While investors want the highest returns possible, returns compensate you for the risks you take — higher risks are generally rewarded with higher returns. Thus, you need to assess how much risk you are willing to take to obtain potentially higher returns. However, this can be a difficult task. It is one thing to theoretically answer questions about how you would react in different circumstances and quite another to actually watch your investments decrease significantly in value. What you are trying to assess is your emotional tolerance for risk, or how much price volatility you are comfortable with. Some questions that can help you gauge your risk tolerance include:

- **What long-term annual rate of return do you expect to earn on your investments?** Your answer will help determine the types of investments you need to choose to meet that target. Review historical rates of return as well as variations in those returns over a long time period to see if your estimates are reasonable. Expecting a high rate of return may mean you'll have to invest in asset classes you aren't comfortable with or that you may be tempted to sell frequently. A better alternative may be to lower your expectations and invest in assets you are comfortable owning.
- **What length of time are you investing for?** Some investments such as stocks should only be purchased for long time horizons. Using them for short-term purposes may increase the risk in your portfolio, since you may be forced to sell during a market downturn.
- **How long are you willing to sustain a loss before selling?** The market volatility of the past several years will give you some indication of how comfortable you are holding investments with losses.
- **What types of investments do you own now and how comfortable are you with those investments?** Make sure you understand the basics of any investments you own, including the historical rate of return, the largest one-year loss, and the risks the investment is subject to. If you don't understand an investment or are not comfortable owning it, you may be tempted to sell at an inopportune time. Over time, your comfort level with risk should increase as your understanding of how risk impacts different investments increases.
- **Have you reassessed your financial goals recently?** Due to the significant market volatility of the past few years, your financial plan may need to be revamped. Otherwise, you may find you won't have sufficient resources in the future to meet your goals. Based on your current investment values, determine what needs to be done to meet your financial goals. You may need to save more, change or eliminate some goals, or delay your retirement date.

- **Do you understand ways to reduce the risk in your portfolio?** While all investments are subject to risk, there are some risk-reduction strategies you should consider for your portfolio. These strategies include:

**Diversify your portfolio.** Diversifying among several investment and insurance categories allows for a variety of resources and methods to meet your short- or long-term goals. A properly diversified portfolio may contain a combination of cash, stocks, bonds, mutual funds, annuities, properties, and so on.

**Stay in the market through different cycles.** Remaining in the market over the long term helps reduce the risk of receiving a lower return than expected, especially for more volatile investments, such as stocks.

**Use dollar cost averaging to invest.** Rather than accumulating cash so you have a large sum to invest, invest small amounts regularly. Dollar cost averaging is a method of investing a certain sum of money in set amounts at regular intervals. This spreads your purchases over a period of time, keeping you from making one major purchase at high prices. Since you are investing a set amount, you purchase more shares when prices are lower and fewer shares when prices are higher. While a valuable investment strategy, dollar cost averaging does not ensure a profit or protect against losses in declining markets. Before starting a program, consider your ability to continue purchases during periods of low price levels. This strategy requires the discipline to invest consistently regardless of market prices and can help develop a habit of regular investing.

Use us as a resource to help you assess your existing risk tolerance against your existing assets. ❍❍❍

## Creamy Horseradish Potato Salad

This is an excellent twist on the popular potato salad for your summer get-togethers. We offer a few options to personalize the recipe. Adapted from the *Food Network* kitchens.

**1 lb. Potatoes—Russet, Red, or Yukon Gold**

**1 T. Apple Cider Vinegar**

**¼ C. Mayonnaise**

**¼ C. Sour Cream *(regular or low fat)***

**1–2 Celery Stalks, Chopped**

**1 T. Horseradish**

**2 T. Chives, Chopped**

**½ t. Salt**

**Pepper to taste, Optional**

**FAGE Plain Greek Yogurt to taste, Optional**

Wash, chop, and peel the potatoes. (Leaving some skin on the potatoes allows for a healthier meal.) Boil the potatoes in lightly salted water until tender. Drain water, and allow the potatoes to cool enough so they're no longer steaming.

Add the apple cider vinegar, ½ teaspoon salt, and celery to the cooked potatoes. Gently stir together.

In a separate bowl, mix together the mayonnaise, sour cream, and horseradish. Fold the mixture into the potatoes. Sprinkle the chives throughout the potato salad while stirring in the mixture. Add salt and pepper to taste. Serve right away or chill and serve.

If you want to lower the cholesterol, you can substitute FAGE plain greek yogurt for the mayonnaise. If you've never tried substituting plain yogurt for mayonnaise, try 1–2 tablespoons of yogurt for the mayo until you get used to the difference. The yogurt is a bit more tangy and bright than mayo, but it provides the same consistency.

## Investment Answers News

With spring wrapping up and heading into the summer months, it is an ideal time to review your finances. Many are still paying off holiday purchases, tuitions are due for children or grandchildren, and New Year's Resolutions are often long gone. Did you intend to implement a budget for 2018? If so, how are you holding up on your expenses and savings plan?

When families get together during the holiday season, emotions can run high. We recommend taking the summer months to review your own Financial Fitness and schedule those Family Meetings that you've been thinking might be a good idea.

Keep in mind with the 2018 tax changes, if you are on a fixed income from your retirement accounts, you may need to make adjustments to your tax withholdings so you're not giving away too much of the money you've already earned to your state or the federal government in 2018.

We're here to help with all of these challenges and opportunities. Call the office at 502-690-3434 to schedule an appointment, or schedule online at:

**http://investmentanswers.net/schedule-a-meeting**

# Financial Thoughts

In a recent survey, those who claimed Social Security benefits before full retirement age did so primarily because they stopped working (Source: National Bureau of Economic Research, 2017).

It seems children have a negative effect on retirement preparedness. Each child increases the risk of not being able to fund retirement by two percentage points. The increased risk is due to women with children having lower labor participation rates and earning lower wages. At the same time, consumption is higher. The cost for a family of four is 40% greater than the cost for two adults (Source: Center for Retirement Research at Boston College, 2017).

Postponing claiming Social Security benefits from age 62 until age 70 increases the size of benefits by about 75%. Delaying impacts not only the benefits at the time of claiming, but also the survivor benefit for married couples. The Society of Actuaries says nearly half of widows have no income other than Social Security (Source: Society of Actuaries, May 2017).

A recent study found that a preference for value, growth, large, or small stocks is related to an investor's personality (Source: *AII Journal*, October 2017).
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