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Financial Briefs

NOVEMBER 2024

What's 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 factors 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 right amounts to 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 should have 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, consider making only 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 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 space against 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 while also paying for basic necessities, like groceries and gasoline, you're living beyond your means and should cut back on your spending.

Third Priority: Retirement Savings

Finally, it's imperative to 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

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How to Improve Your Credit Rating

Credit scores are important because they determine your ability to get a loan, which most people need to buy a house or a car and maybe even to send a child to college. Credit scores also impact the interest rate and fees you will pay on that loan. Additionally, it can affect whether a landlord will rent to you, an employer will hire you, an insurance company will cover you, and if utility companies will turn on services. While you need credit to get credit, having healthy credit is a balancing act.

What Is a Good Credit Score?

While creditors use different credit scoring models, the following provides a good example of score ranges:

750 and above	Excellent
700–749	Good
650–699	Fair
550–649	Poor
550 and below	Bad

The scoring models use five key factors in determining your credit score, including:

- **Payment history** determines how much of a risk you are to creditors in your ability to make timely payments.
- **Amount of debt** shows how

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What's Better?

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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). 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.

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.

Paying Off Your Mortgage

There are advantages and disadvantages to paying off your mortgage. On the positive side, any extra money sent with your mortgage payment is applied to the outstanding principal, which can significantly reduce your total interest cost. This reduces your interest expense deduction on your tax return, but you are paying most of the cost anyway. For instance, if you're in the 24% tax bracket, you save 24 cents in taxes for every dollar of interest, but you're still paying the remaining 76 cents.

When paying down principal, you are effectively earning a pretax return equal to your mortgage interest rate, which is a guaranteed return with no risk. Most mortgages allow you to add as much to the payment as you like.

On the other hand, instead of prepaying your mortgage, you might want to use additional funds to invest in investments with the potential to earn higher returns.

Consider the following factors before prepaying your mortgage:

- **Are all components of your financial plan in place?** Before prepaying your mortgage, make provisions for things like disability insurance, life insurance, and an emergency reserve fund.
- **Is all your consumer debt paid off?** Consumer debt typically carries interest rates that are higher than your mortgage rate, and interest payments are not typically tax deductible, unless it's a home-equity loan. Thus, you should probably pay off your consumer debt first.
- **Are you maximizing contributions to qualified retirement plans?** Make sure you are contributing the maximum to your 401(k) plan, especially if your employer matches funds, or are fully funding other qualified plans and individual retirement accounts.
- **Have you investigated other investment alternatives?** Look into other investments whose potential returns may exceed the return from prepaying your mortgage. However, make sure you actually make those investments. You don't want to just spend any money that could have gone toward your mortgage.
- **Are you nearing retirement?** As you approach retirement age, the idea of entering retirement with no debts may make prepaying your mortgage a more attractive alternative. Or you may like the certainty of positive returns that comes from prepaying your mortgage.

If you decide to prepay your mortgage, consider these strategies:

- Switch from a 30-year to a 15-year mortgage. By paying the mortgage off 15 years sooner, you save a significant amount of interest.
- Pay half your mortgage payment every two weeks. Over the course of a year, that equals 26 payments or 13 monthly installments. Check with your lender to make sure this option is offered.
- Add additional amounts to your monthly mortgage payment. This option is the most flexible since you decide on a monthly basis how much to add to your payment.

How to Improve

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much credit you have available and how much you are using. If you are holding a lot of debt, creditors worry about your ability to take on more and where they will fall on your payment priority list.

- **Age of accounts** provides creditors with a good understanding of how you manage debt.
- **Account mix** shows lenders how you handle different types of credit; so if you only have credit cards, this may keep your score from rising.
- **History of credit applications** shows how often you are applying for credit and if you are overextending yourself.

If your credit score falls into the fair, poor, or bad range, it's probably time to work on improving that score.

Look at Your Credit Report

The first step to improve your credit score is to review your credit reports from all three of the major credit bureaus. If you find inaccuracies on any of your reports, contact the bureau to find out their process for disputes and resolution.

If your credit reports are accurate and your score is suffering, the following steps can help bring your score into the healthy range:

Pay on Time, Every Time

If you are late or missing payments, you need to set up a plan to make sure your payments are made on time. If your bill comes in at a time during the month when you are low on cash, most lenders and creditors will allow you to change the due date.

Ask for Forgiveness

If you are late with a payment, call your credit card issuer or lender to see if they will forgive the late payment. If you have a consistent track record of on-time payments, they will most likely work with you.

If you have an ongoing debt on your report, contact the lender or creditor to see if they will stop reporting the debt to the credit bureaus if you pay the debt in full.

Consider Your Credit Mix

If you only have one type of credit, it will impact your score. If you've never had a credit card, it may be time to get one. Just make sure you pay your balance off on a monthly basis or make on-time payments.

If your poor credit score is preventing you from getting a credit card, see if you can get a secured credit card from your financial institution. With this type of card, you can secure a line of credit based on deposits into a checking account. For example, if you open a checking account with a $500 deposit, they will extend a line of credit for $500. Adding a new account with a positive payment history goes a long way in improving your score.

Not Too Many Cards

Don't go overboard, because the more credit you apply for in a short period of time, the greater damage it will do to your credit report. Also, it can be very attractive to get a discount for signing up for a store credit card, but realize your credit score will take a hit. When you apply for credit, it is considered a hard inquiry, which will impact your score regardless if you get approved or not; and it will remain on your report for 12 months. So if your score is in between tiers, too much credit can put you in a lower tier.

Watch How Much You Use

Your score will suffer if every month your credit card balances are more than 30% of your limit. Even if you pay off your balance each month, a higher utilization rate will negatively impact you. If you know your balance is going to be above 30% in a given month, prepay some or all of the balance so you will be in the safe zone.

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

Do You Have Too Much Debt?

Various rules of thumb exist to help determine when debt levels are excessive. For instance, one rule of thumb states your total debt payments, including your mortgage and credit card bills, should not exceed 36% of your gross monthly income. The problem with rules of thumb, however, is they don't take into account your unique circumstances. Look for these signs that your debt level may be getting too high:

- **You have no money left over at the end of the month.** If you have nothing left to save after paying your bills every month, your debt may be too high. Be especially concerned if you have to dip into savings to pay bills.
- **You've reached your maximum credit limit.** If you've maxed out your credit card limits or are considering obtaining new cards for additional credit, your debt may be getting out of hand. Credit cards should be used as a convenience, not to finance an unaffordable lifestyle.
- **You're only making minimum payments.** Required minimum payments on credit card debt are so low that it can take decades to pay off the debt. It will be difficult to get your debt under control if you are only making minimum payments.
- **You don't have an emergency fund.** Ideally, you should set aside three to six months of living expenses in case of emergencies, such as a job loss or major home or car repair. If you can't maintain that due to debt payments, your debt level is probably too high.
- **You're not comfortable.** The ultimate test of whether your debt level is too high is your comfort with that debt and the payments that must be made.

If your debt level is too high, take steps now to get your debt under control. Please call if you'd like help with your debt.

News and Announcements

From The Bolander Household

Weekend getaway, family, fun, magic wands, enchanted forest, water goggles, sliding and splashing, pumpkin lattes and lots of candy! Fall break in October was the perfect time to go with my daughter and grandchildren to the Great Wolf Lodge in Grapevine, Texas. It was our first adventure to the massive indoor water park, but it wasn't long before we donned our wolf ears and became members of the wolf pack, howling heartily on cue when the larger-than-life Wylie Wolf and other woodland characters made appearances for photos and activities. When we weren't swimming or sliding through the water park, the grandchildren hunted for magic gems and coins in the hallways of the hotel. A few floors were lined with magical forest features that told stories, gave hints, and awarded imaginary gems and gold coins (points). Our grandson, Luke, had surprisingly good luck – at times when he walked past a feature it would light up and add coins to his magic wand. This highly irritated Luke's sister, Stella, since she had perfected the point and flick movement as instructed by the forest elf in the wand store, but many times she received only half the coins her brother did. At the end of the stay, everyone agreed that the best parts of the trip were riding the canyon river raft together and then relaxing in the wave pool.

Happy Thanksgiving!

Brenda C. Bolander, CFP®
CPA/PFS™
Executive Vice President

From the Rudy Household

It's hard to believe that this November marks my 15th anniversary with Retirement Investment Advisors! It feels like just yesterday that I was starting out, eager to put my passion for financial planning into practice. My journey has been a bit unconventional, to say the least.

While an undergrad at OU, I had interest in both MIS & Finance and decided to double major. During a senior-year financial planning course, something clicked, and I discovered that finance was what I truly enjoyed. But by then, graduation was around the corner, and I had already accepted a position with Exxon in their IT department. A few years later, I decided to pursue my MBA at Rice with the intention of making a career switch to finance. However, while in grad school, I had developed a CRM software package for the home-building industry and chose to continue down that path for a few more years.

Finally, a decade later, I returned to Rice for my CFP® certification. After passing the exam, I sought the advice of a family friend who happened to be the CEO at Retirement Investment Advisors, Randy Thurman. He graciously helped me transition into the financial planning industry and I'm incredibly grateful for his support and for the opportunity to do what I love every day.

I appreciate my clients that took a risk with me early in this journey and I'm proud to say that those first clients are still with me 15 years later. Thank you to ALL my clients for your trust and for allowing me to help you reach your financial goals. It is a true honor to work with you.

Chad A. Rudy, CFP®, RSSA®
Executive Vice President - TX

From the Sterling Household

The adventures in launching my daughter into the world continue. We spent fall break touring schools in Massachusetts (and managed to squeeze in a little fall-themed fun as well). I was pretty sure I was making a mistake by taking Avery to New England in the peak of fall, and I am afraid that I was right. I should have planned a trip in the throes of winter so that my Oklahoma girl that never wears a coat could experience a real winter. But alas, I took her to Boston in the most beautiful time of year. Naturally, she fell in love. Massachusetts is now making its way to the top of her list.

It seems that a lot has changed in the college admissions process. For one, the Common Application makes life a little easier. If you haven't had a college-bound student in recent years, you may not be familiar with it, but over 1100 schools now use the Common App, a centralized application submission platform, making applying for schools much easier. With that said, more and more kids are applying for college, making the admissions process more competitive. It can be a bit daunting as a parent (and a kid), but we're finding our way through. Senior year came very quickly!

Sylvia L. Sterling, CFP®, CDFA®
Senior Vice President

Retirement Investment Advisors, Inc.
Holiday Hours

Thanksgiving
Thursday, November 28, 2024 – Closed
Friday, November 29, 2024 – Closed