



# The Abel Advisor

a Financial Stewardship Newsletter

## Abel Financial Strategies

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Hi Everyone,

July was an improving summer month. The rain in Ohio finally stopped. There was a point where we had had about 20 straight days of rain! The record is 22!

The markets saw some recovery in July as the Greek crisis started to get resolved. They still have a long way to go but there has been progress. That means a lot to Europe and the other countries that have been bailed out. Which in turn means a lot to the many US companies that sell product in Europe.

Our college visits have gone well and we have it narrowed down to 3 schools. My son will be a High School Junior this year, so we are on target for the college process.

Please enjoy and share the articles and let me know if you have any questions.

God's Peace,  
A.W.

### August 2015

Financial Mistakes People Make at Different Ages

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## Financial Mistakes People Make at Different Ages



There's a saying that with age comes wisdom, but this may not always be true in the financial world. As people move through different life stages, there are new opportunities--and potential pitfalls--around every corner.

### In your 20s

*Living beyond your means.* It's tempting to want all the latest and greatest in gadgets, entertainment, and travel, but if you can't pay for most of your wants up front, then you need to rein in your lifestyle. If you take on too much debt--or don't work diligently to start paying off the debt you have--it can hold you back financially for a long, long time.

*Not saving for retirement.* You've got plenty of time, so what's the rush? Well why not harness that time to work for you. Start saving a portion of your annual pay now and your 67-year-old self will thank you.

*Not being financially literate.* Many students graduate from high school or college without knowing the basics of money management. Learn as much as you can about saving, budgeting, and investing now so you can benefit from it for the rest of your life.

### In your 30s

*Being house poor.* Whether you're buying your first home or trading up, don't buy a house that you can't afford, even if the *bank* says you can. Build in some wiggle room for a possible dip in household income that could result from switching jobs, going back to school, or leaving the workforce to raise a family.

*Not protecting yourself with life and disability insurance.* Life is unpredictable. What would happen if one day you were unable to work and earn a paycheck? Let go of the "it-won't-happen-to-me" attitude. Though the cost and availability of life insurance depend on several factors including your health, the younger you are when you buy insurance, the lower your premiums will likely be.

*Not saving for retirement.* Okay, maybe your

20s passed you by in a bit of a blur and retirement wasn't even on your radar screen. But now that you're in your 30s, it's critical to start saving for retirement. Wait much longer, and it can be hard to catch up. Start now, and you still have 30 years or more to save.

### In your 40s

*Trying to keep up with the Joneses.* Appearances can be deceptive. The nice homes, cars, vacations, and "stuff" that others have might make you wonder whether you should be buying these things, too. But behind the scenes, your neighbors could be taking on a lot of debt. Take pride in your savings account instead.

*Funding college over retirement.* In your 40s, saving for your children's college costs over your own retirement is a mistake. If you have limited funds, set aside a portion for college but earmark the majority for retirement. Then sit down with your teenager and have a frank discussion about academic options that won't break the bank--for either of you.

*Not having a will or an advance medical directive.* No one likes to think about death or catastrophic injury, but these documents can help your loved ones immensely if something unexpected should happen to you.

### In your 50s and 60s

*Co-signing loans for adult children.* Co-signing means you're on the hook--completely--if your child can't pay, a situation you don't want to find yourself in as you're getting ready to retire.

*Raiding your home equity or retirement funds.* It goes without saying that doing so will prolong your debt and/or reduce your nest egg.

*Not quantifying your retirement income.* As you approach retirement, you should know how much you can expect from Social Security (at age 62, at your full retirement age, and at age 70), pension income, and your personal retirement savings.

*Not understanding health-care costs in retirement.* Before you turn age 65, review what Medicare does and doesn't cover, and how gap insurance policies fit into the picture.



*All investing involves risk, including the possible loss of principal. There can be no assurance that any investing strategy will be successful. Investments offering higher potential rates of return also involve a higher level of risk.*

*Asset allocation and diversification are methods used to manage investment risk; they do not guarantee a profit or protect against a loss.*

## Five Ways to Manage Risk in Your Retirement Savings Plan

Your employer-sponsored retirement savings plan is a convenient way to help you accumulate money for retirement. Using payroll deductions, you invest for the future automatically, following that oft-noted advice to "pay yourself first." But choosing to participate is just one important step. Another key to making it work for you is managing risk in your portfolio. Following are five ways to tackle this important task.

### 1. Know your personal risk tolerance

Gauging your personal risk tolerance--or your ability to endure losses in your account due to swings in the market--is an important first step. All investments come with some level of risk, so it's important to be aware of how much volatility you can comfortably withstand before choosing investments.

One way to do this is to reflect on a series of questions, such as:

- How well would you sleep at night knowing your retirement portfolio dropped 5%? 10%? 20%?
- How much time do you have until you will need the money? Typically, the longer your time horizon, the more you may be able to hold steady during short-term downturns in pursuit of longer-term goals.
- Do you have savings and investments outside of your plan, including an emergency savings account?

Your plan's educational materials may offer worksheets and other tools to help you gauge your own risk tolerance. Such materials typically ask a series of questions similar to those above, and then generate a score based on your answers that may help you choose appropriate investments.

### 2. Develop a target asset allocation

Once you understand your risk tolerance, the next step is to develop an asset allocation mix that is suitable for your savings goal while taking your risk tolerance into consideration. Asset allocation is the process of dividing your investment dollars among the various asset categories offered in your plan, generally stocks, bonds, and cash/stable value investments. If you're a young investor with a hardy tolerance for risk, you might choose an allocation composed heavily of stocks. On the other hand, if retirement is less than 10 years away and you fear losing money, your allocation might lean more toward bonds and cash investments.

### 3. Be sure to diversify

Even the most aggressive investor can potentially benefit from diversification, which generally means not putting all your eggs in one basket. Let's take one example from above: Although that young investor may choose to put a large chunk of her retirement account in stocks, she should still consider putting some of the money into bonds and possibly cash to help balance any losses that may occur in the stock portion. Even within the stock allocation, she may want to diversify among different types of stocks, such as domestic, international, growth, and value stocks.

### 4. Understand dollar cost averaging

Your plan also helps you manage risk automatically through a process called dollar cost averaging (DCA). When you contribute to your plan, chances are you contribute an equal dollar amount each pay period, which then purchases shares of the investments you have selected. This process--investing a fixed dollar amount at regular intervals--is DCA. As the prices of the investments you purchase rise and fall over time, you take advantage of the swings by buying fewer shares when prices are high and more shares when prices are low--in essence, following the old investing adage to "buy low." After a period of time, the average cost you pay for the shares you accumulate may be lower than if you had purchased all the shares with one lump sum.

Remember that DCA involves continuous investment in securities regardless of their price. As you think about the potential benefits of DCA, you should also consider your ability to make purchases through extended periods of low or falling prices.

### 5. Perform regular maintenance

Although it's generally not necessary to review your retirement portfolio too frequently (e.g., every day or even every week), it is advisable to monitor it at least once per year and as major events occur in your life. During these reviews, you'll want to determine if your risk tolerance has changed and check your asset allocation to determine whether it's still on track. You may want to rebalance--shifting some money from one investment to another--to bring your allocation back in line with your target. Or you may want to make other changes in your portfolio to keep it in line with your changing circumstances. Such regular maintenance is critical to help manage risk in your portfolio.





*All calculations assume constant monthly payments over the life of the loan, monthly calculation of interest on the remaining unpaid principal, and no prepayment.*

*This information is provided for illustrative purposes only. The actual amount of interest you'll pay on a loan will depend on several factors, including the amount you borrow, the interest rate, the repayment term, and loan conditions.*

## The Cost of Credit

Sometimes you need to borrow money, especially to pay for a large purchase such as a home or a car. It's easy to focus on your monthly loan payment, but to appreciate how much borrowing money might really cost, you also need to consider the amount of interest you'll pay over time. The following tables illustrate the total interest paid over the life of three common types of loans that have a fixed annual interest rate and a fixed repayment term: mortgage loans, auto loans, and personal loans.

### Mortgage loans

A home is often the biggest purchase you'll ever make. Loan repayment terms vary; this chart illustrates the total interest paid over a 30-year repayment term.

Loan amount	3%	4%	5%	6%
\$250,000	\$129,444	\$179,674	\$233,139	\$289,595
\$350,000	\$181,221	\$251,543	\$326,395	\$405,434
\$450,000	\$232,999	\$323,413	\$419,651	\$521,272
\$550,000	\$284,776	\$395,282	\$512,907	\$637,110
\$650,000	\$336,553	\$467,152	\$606,163	\$752,948
\$750,000	\$388,331	\$539,021	\$699,418	\$868,786

### Auto loans

You may take out a loan to buy a new or used vehicle. Loan repayment terms vary; this chart illustrates the total interest paid over a 60-month repayment term.

Loan amount	2%	4%	6%	8%
\$15,000	\$775	\$1,575	\$2,400	\$3,249
\$20,000	\$1,033	\$2,100	\$3,199	\$4,332
\$25,000	\$1,292	\$2,625	\$3,999	\$5,415
\$30,000	\$1,550	\$3,150	\$4,799	\$6,498
\$35,000	\$1,808	\$3,675	\$5,599	\$7,580

### Personal loans

A personal loan is unsecured, meaning that no collateral is required, so the interest rate on this type of loan is typically higher than for a secured loan. Loan repayment terms vary; this chart illustrates the total interest paid over a 36-month repayment term.

Loan amount	6%	8%	10%	12%
\$8,000	\$762	\$1,025	\$1,293	\$1,566
\$10,000	\$952	\$1,281	\$1,616	\$1,957
\$12,000	\$1,142	\$1,537	\$1,939	\$2,349
\$14,000	\$1,333	\$1,794	\$2,263	\$2,740
\$16,000	\$1,523	\$2,050	\$2,586	\$3,131



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### What return are you really earning on your money?

If you're like most people, you probably want to know what return you might expect before you invest. But to translate a given rate of return into actual

income or growth potential, you'll need to understand the difference between *nominal return* and *real return*, and how that difference can affect your ability to target financial goals.

Let's say you have a certificate of deposit (CD) that's about to expire. The yield on the new three-year CD you're considering is 1.5%.

But that 1.5% is the CD's nominal rate of return; it doesn't account for inflation or taxes. If you're taxed at the 28% federal income tax rate, roughly 0.42% of that 1.5% will be gobbled up by federal taxes on the interest. Okay, you say, that still leaves an interest rate of 1.08%; at least you're earning something.

However, you also need to consider the purchasing power of the interest that the CD pays. Even though inflation is relatively low today, it can still affect your purchasing power, especially over time. Let's say that consumer prices have gone up by 1% over the past year

and you adjust your 1.08% after-tax return for inflation. Suddenly, you're barely breaking even on your investment.

What's left after the impact of inflation and taxes is your real return, because that's what you're really earning in actual purchasing power. If the nominal return on an investment is low enough, the real return can actually be negative, depending on your tax bracket and the inflation rate over time. Though this hypothetical example doesn't represent the performance of any actual investment, it illustrates the importance of understanding what you're really earning.

Knowing the difference between nominal and real return may help you make better decisions when it comes to investing your money. You'll want to choose investments that match your financial goals and tolerance for risk. In some cases, the security an investment offers may be important enough that you're willing to accept a low real return; in other cases, you may choose an investment that has the potential for a higher real return but carries a higher degree of risk.



### Are stock dividends reliable as a source of income?

Dividends can be an important source of income. However, there are several factors you should take into consideration if you'll be relying on them to help pay the bills.

An increasing dividend is generally regarded as a sign of a company's health and stability, and most corporate boards are reluctant to cut them. However, dividends on common stock are by no means guaranteed; the board can decide to reduce or eliminate dividend payments. Investing in dividend-paying stocks isn't as simple as just picking the highest yield; consider whether the company's cash flow can sustain its dividend, and whether a high yield is simply a function of a drop in a stock's share price. (Because a stock's dividend yield is calculated by dividing the annual dividend by the current market price per share, a lower share value typically means a higher yield, assuming the dividend itself remains the same.)

Also, dividends aren't all alike. Dividends on preferred stock typically offer a fixed rate of return, and holders of preferred stock must be paid their promised dividend before holders of common stock are entitled to receive theirs.

However, because their dividends are predetermined, preferred stocks typically behave somewhat like fixed-income investments. For example, their market value is more likely to be affected by changing interest rates, and most preferred stocks have a provision allowing the company to call in its preferred shares at a set time or at a specified future date. If you have to surrender your preferred stock, you might have difficulty finding an equivalent income stream.

Finally, dividends from certain types of investments aren't eligible for the special tax treatment generally available for qualified dividends, and a portion may be taxed as ordinary income.

**Note:** *All investing involves risk, including the potential loss of principal, and there can be no guarantee that any investing strategy will be successful. Investing in dividends is a long-term commitment. Investors should be prepared for periods when dividend payers drag down, not boost, an equity portfolio. A company's dividend can fluctuate with earnings, which are influenced by economic, market, and political events.*

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