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Personal Finance

On Topic

Q: As the economy copes with the after-effects of a lingering recession, what personal finance dos or don’ts should people keep in mind this year?

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People spend way too much time, now and always, trying to figure out where the market is going next week or what the hot investment will be over the next six months. Nobody has consistently useful answers to those questions in the long run. Instead, anyone who wants to get rich and stay rich should focus on the real drivers of financial security — savings rate for those still working, or spending rate for those in retirement. Assuming a sensible investment strategy (Google “John Bogle” for some excellent baseline ideas), the short-term and long-term fluctuations of the market are noise. The signal is what you spend or save. If you are working, and you save a high proportion of your income, you will be just fine — especially if markets decline.

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Investors must maintain a level head; many tend to become overly emotional in times of heightened volatility. Investors seeking the super safe or crash-proof portfolio typically don’t have an inflation-proof portfolio. Many investors don’t fully understand the risks to fixed income in an inflationary environment. Hedging must play an important role in any investors’ portfolio, both the total fees to hedge as well as the opportunity cost, or what is given up in return for reduced risk must be understood. Some techniques we use to hedge are: maintaining a diversified portfolio, covered call writing, protective put buying, structured products, closed-end funds when they trade at relative discounts, ETFs, as well as purchasing investments we believe will be profitable in an inflationary environment.

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Reduce costs by using passive/index funds; save 1.2 percent per year. Construct a risk-appropriate, globally-diversified, tax-efficient portfolio of low-cost passive funds. Consider a Roth conversion; move money from tax-deferred to tax-free status. Revisit your estate plan because congressional inaction has eliminated the estate tax. If you don't know how to do it yourself, use a fiduciary adviser, not a broker. Saves lots of money because un-conflicted advice is the best advice.

Ivor Mills

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The biggest personal finance "do" this year is to make a budget and stick to it, because at the end of the day, the money you spend or save is the most important factor in achieving your goals. Getting a handle on your budget also provides the opportunity for another "do:" allowing you to set aside emergency funds (three to six months of living expenses) in liquid, relatively safe investments.

Don't just buy, hold and hope everything works out. It's incredibly important to have a plan in place to reach your long- and short-term savings goals — and to do so at a risk tolerance that's right for you. Also, don't abandon your plan during tough times; it's then that it needs your discipline and highest level of involvement the most.

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Do take stock of your situation. Project your financial situation to at least age 80, and make adjustments to your savings and investment strategy if necessary. Do pay down any high-interest debt. Credit card rates are nothing short of financial assassins in this environment. Do keep a cash cushion. Rainy days happen. The rule of thumb is to have six months living expenses available.

Don't try to predict the future. Timing the markets doesn't work. Don't try to get everything you lost back fast. Slow and steady wins the race. Good diversification may be your best strategy. Do seek help if you need it. Consult with a professional you trust or is a trusted referral. Good advice pays for itself, and then some.

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If the financial markets have "challenged" your retirement plans, keep the following in mind: If you haven't retired yet, the most proactive thing you can do to improve your situation is to delay retiring. Even one or two more years of working can have a significant impact on your financial future. Not only will you not be spending down your capital, but your Social Security and investments also will have a chance to grow more, especially if you receive a company match into your 401(k). If you are already retired, consider creative ways to increase income. Start a small business from home, take in a boarder, sell doodads on eBay, or call in the loans you gave to relatives!

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The number one "do" for people should be looking at reducing debt. Interest rates are at historic lows and present many opportunities to refinance high-interest debt or begin making more principal payments before rates increase in the near future. Individuals and businesses are sitting on cash earning close to 0 percent while the outlook for the market is gloomy at best in the short term. A big "don't" would be the mistake of stopping or slowing your investment into a 401(k) plan. Contributing to a 401(k) allows a great immediate tax advantage and this systematic investment can reduce the risk of investing all at one price. Lastly, review your current asset allocation. The beginning of New Year is great time to consider rebalancing. Remember to consult with a professional regarding your situation before making any decisions.

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In the aftermath of the past 18 months of economic turmoil, many people are in a state of near or total paralysis — it feels “safer” to do nothing, staying on the sidelines, waiting for all of the dust to settle. While this reaction is understandable from a psychological perspective, experience over numerous economic cycles has taught us that failure to act is a decision.

So, if you are among those who believe that one of the many unfortunate results of the recession is the likelihood that taxes will increase, don’t decide to do nothing. Do take a deep breath and make the time for a careful look at your current income tax situation and estate plan. These simple steps will enable you to take advantage of any planning that you can do this year that may lessen your tax liabilities in the years to come.

— Compiled by Sonja Sherwood