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THE ADVISOR

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Now is the Right Time to Reassess Your Risk Tolerance

What will the presidential election result mean for the financial markets? No one knows right now. However, history tells us that even in years when the presidential election has a dramatic impact on the markets, the drama is temporary and ultimately means little in the long run. With the coronavirus pandemic still weighing heavily on the U.S. economy, it seems a safe bet that history will repeat itself again this year. The markets held steady and even rose a bit during election week. Although Wall Street may still experience a spike or slump based on whether there is a power shift in Washington, when the dust settles, the pandemic and a few other related issues will once again be the main things on the minds of big investors.

Chief among those related issues is the second round of federal aid that has yet to be approved by Congress. This could become the major factor when you consider Covid-19 cases are spiking across the country (and across the globe) once more, and that the economic impact of the pandemic is expected to worsen during the fall and winter.[1] Can another relief package soften that impact? Or could things get bad enough (with or without more federal aid) to trigger the kind of investor panic we saw in March, when all the major indexes dropped by nearly 40%?

Anything is possible, but as we've discusses before, if another pullback does occur it will be less rapid and less steep than the drop in March. With all of this in mind, there is one important question that investors in or nearing retirement need to ask themselves in the midst of this uncertainty: "Is my allocation still where I want it to be based on my risk tolerance?"

Emotional Gauge

Now is a perfect time to reassess your risk tolerance with your advisor because you can use what's been happening in the markets as an emotional gauge. Think back to when that major drop occurred in March. It was a panicked response to the World Health Organization declaring the coronavirus a global pandemic, and it affected everything. Growth-based investors saw their mutual funds shrink, but income-based investors also saw the values of their bonds and bond-like instruments drop. Your reaction at the time may have been to feel a sense of panic even though you knew that at the end of the day your loss was only a paper loss and your income was unaffected. If you were nervous, you may want to discuss the possibility of lowering your investment risk

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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.

The Debt-Free Retirement Goal

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, which means you'll have to draw more from your nest egg and have less to spend on things you truly enjoy. By going into retirement debt free, you'll lower your living expenses,

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Now is the Right Time

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further — now that you've had this experience and realized just how risk averse you really are.

On the other hand, your reaction to the market panic in March may have been to take it all in stride. The knowledge that your income was more secure was enough to quell any sense of fear, and the market's rapid rebound and relative stability ever since may have you thinking now about potential opportunities. In other words, the experience may have helped you realize your risk tolerance is higher than you thought — high enough that you may now want to discuss revising your portfolio to be slightly more aggressive if your goal is to increase income or total return potential. The good news, as we've discussed in previous newsletters, is that you can do this while still keeping your strategic focus on income through an actively managed portfolio of dividend paying value stocks.

The bottom line is that by reassessing your risk tolerance right now, you can be confident your allocation is still aligned with your goals no matter how shaky the markets get in the weeks and months to come. If your risk tolerance is lower, you'll know your allocation is set up for greater protection and reliable income. If you've realized your risk tolerance is a little higher, you can amend your allocation to possibly increase your dividend yield and your potential for a bit more portfolio growth.

Permanent Low Interest Rates

Here's another reason why all of this is so important right now. We believe permanent low interest rates are the new normal, and that appears more certain than ever in the wake of Covid-19 and its impact on the markets. That means active management will remain a crucial part of Investing for Income as various risks and challenges arise in the bond market.

For you, it's important to understand all those potential risks and challenges, and to make sure your financial strategy is still perfectly aligned with your own risk tolerance and your individual retirement goals. Now is the perfect time to do it!

[1] "It's About to Get Even Worse," Axios, Oct. 12, 2020

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Is There Such a Thing as Good Debt?

Good debt is basically defined as financing something that will increase your income or net worth, while bad debt is just the opposite. You should try to think of good debt as an investment. You're borrowing money now with the hopes that the asset purchased will increase in value over time.

What you want to do is try to minimize your bad debt and maximize your good debt. When you consider a purchase, think like an investor. Will you make a profit from the purchase? Will it help with your future? Will it help you earn income? If you answer no, then you may want to wait to make the purchase.

Following are examples of good debt:

Education — Taking out a loan for college or technical training is an investment in your future. After years in the workforce, it will most likely pay for itself. Typically, better educated people have greater earning potential and have an easier time finding good-paying opportunities.

Owning a Business — Entrepreneurs who are willing to work hard and have the ambition needed to run a business can turn a small business loan into a successful venture. Hopefully, this investment in yourself will result in a business that is self-sustaining with a good profit.

Purchasing Real Estate — There are several different ways to make money on real estate. The most common is taking a mortgage to purchase a home and then selling it at a profit after many years. Investing in residential real estate by renting out a home or apartment is also good debt that can provide you with ongoing income. And commercial real estate, such as an office building, store, or industrial park, can return good profits and capital gains.

Here are some examples of bad debt:

Vehicles — For many, vehicles are a necessity and an expensive one. When you take a loan to buy a car, the minute you drive off the lot, the car loses a significant portion of its value. Financially, it would make more sense to purchase a used car with cash or finance a smaller amount.

Consumable Goods — We all need clothing to wear, food to eat, gas for our cars, and the occasional get-away trip, but many buy these items with borrowed money instead of cash. Not only are these items probably worth less than what we pay for them, but interest on the debt increases the price substantially.

Credit Cards — When credit cards are used to pay, they are doing nothing to increase your income or your net worth. The interest rates can be incredibly high over other types of consumer loans and the payments are designed to maximize the costs to the consumer. And, if you don't pay your balances in full each month, your debt could quickly get out of hand.

Please call if you'd like to discuss debt in more detail.

Your Retirement

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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 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 near retirement with 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 before you retire? Please call if you'd like to discuss this in more detail.

How to Avoid Credit Card Dependence

Ask yourself these questions to evaluate your dependence on credit cards:

- Do you rely on credit cards to make it until your next paycheck?
- Does it seem you always have to put unexpected expenses on your credit card?
- Do you think you spend more than you would with cash because your card has rewards or discounts?
- Do the holidays leave you with a mountain of credit card debt?

If you answered yes to these questions, you are probably relying too much on your credit cards. If you are concerned that you are too dependent on your credit cards, there are steps you can take to become credit card independent.

- Put your credit cards somewhere for safekeeping to reduce the temptation to use them as your regular form of payment.
- Become more disciplined with spending by enacting a cash-only policy. While many people use debit cards as a convenient way to pay cash, be careful. Many financial institutions will allow you to overdraft your account when you use a debit card and may charge a large fee for this overdraft privilege.
- Consolidate your balances to the cards that have the lowest interest rates and close the rest of your credit card accounts to reduce the amount of available credit and, thus, the potential amount of debt you could incur. While closing credit cards can have a negative impact on your credit score, it's still better to have a temporary credit score setback than to go deeper into debt if you can't control your spending. To reduce the impact to your score, you should also consider keeping your oldest credit card in addition to a lower interest-rate card.
- Shock yourself into reality by looking at a few important things on your credit card statement, including how much you are paying in interest on an annual basis, how long it will take you to pay off the balance, and how much you will pay in interest if you are only making the minimum monthly payment. This information can be a real eye-opener.

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

Business Data

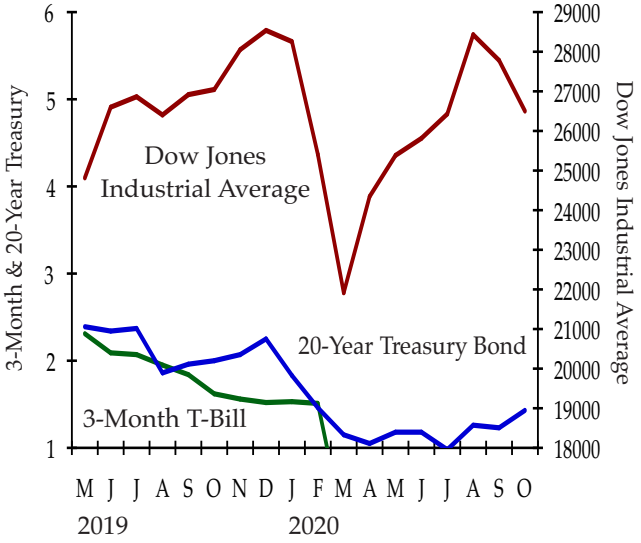
Indicator	Month-end Aug-20	Sep-20	Oct-20	Dec-19	Oct-19
Prime rate	3.25	3.25	3.25	4.75	4.75
3-month T-bill yield	0.10	0.10	0.10	1.52	1.62
10-year T-note yield	0.72	0.69	0.88	1.92	1.69
20-year T-bond yield	1.26	1.23	1.43	2.25	2.00
Dow Jones Corp.	2.22	2.17	2.23	2.84	2.90
GDP (adj. annual rate)#	-5.00	-31.40	+33.10	+2.10	+2.10

Indicator	Month-end Aug-20	Sep-20	Oct-20	% Change YTD	12 Mon
Dow Jones Industrials	28430.05	27781.70	26501.60	-7.1%	-2.0%
Standard & Poor's 500	3500.31	3363.00	3269.96	1.2%	7.7%
Nasdaq Composite	11775.46	11167.51	10911.59	21.6%	31.6%
Gold	1970.00	1886.90	1881.85	23.6%	24.5%
Unemployment rate@	10.20	8.40	7.90	125.7%	125.7%
Consumer price index@	259.10	259.92	260.28	1.2%	1.4%

— 1st, 2nd, 3rd quarter @ — Jul, Aug, Sep Sources: *Barron's, Wall Street Journal*
Past performance is not a guarantee of future results.

18-Month Summary of Dow Jones Industrial Average, 3-Month T-Bill & 20-Year Treasury Bond Yield

May 2019 to October 2020



Set Your Own Debt Limits

Credit can be a valuable tool that allows you to purchase major items and pay for them over time. But the ready availability of credit also makes it easy to incur more debt than you can comfortably repay. Rather than allowing lenders to set credit limits for you, evaluate your financial situation and determine your own limits.

To find out where you stand with consumer debt, which includes all debt except your mortgage, make a list of your debts and monthly payments. Then calculate your debt ratio by dividing your monthly debt payments by your monthly net income. The general guideline is that your debt ratio should not exceed 10% to 15% of your net income, with 20% usually considered the absolute maximum. However, you should consider your own circumstances and decide how much debt you are comfortable with.

Before purchasing something on credit, carefully evaluate whether it makes financial sense to do so. Some questions to ask yourself include:

- Should I wait and save the money so I can pay cash for the item?
- Will the cost of the item increase or decrease in the future?
- Is it really worth paying interest on the item so I can use it now?
- Will I still be within my designated debt limits if I add this new debt payment?
- Will the item still have value after I finish paying for it?

Setting your own debt limit and carefully evaluating whether you should purchase an item on credit should help you keep your debt under control.

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