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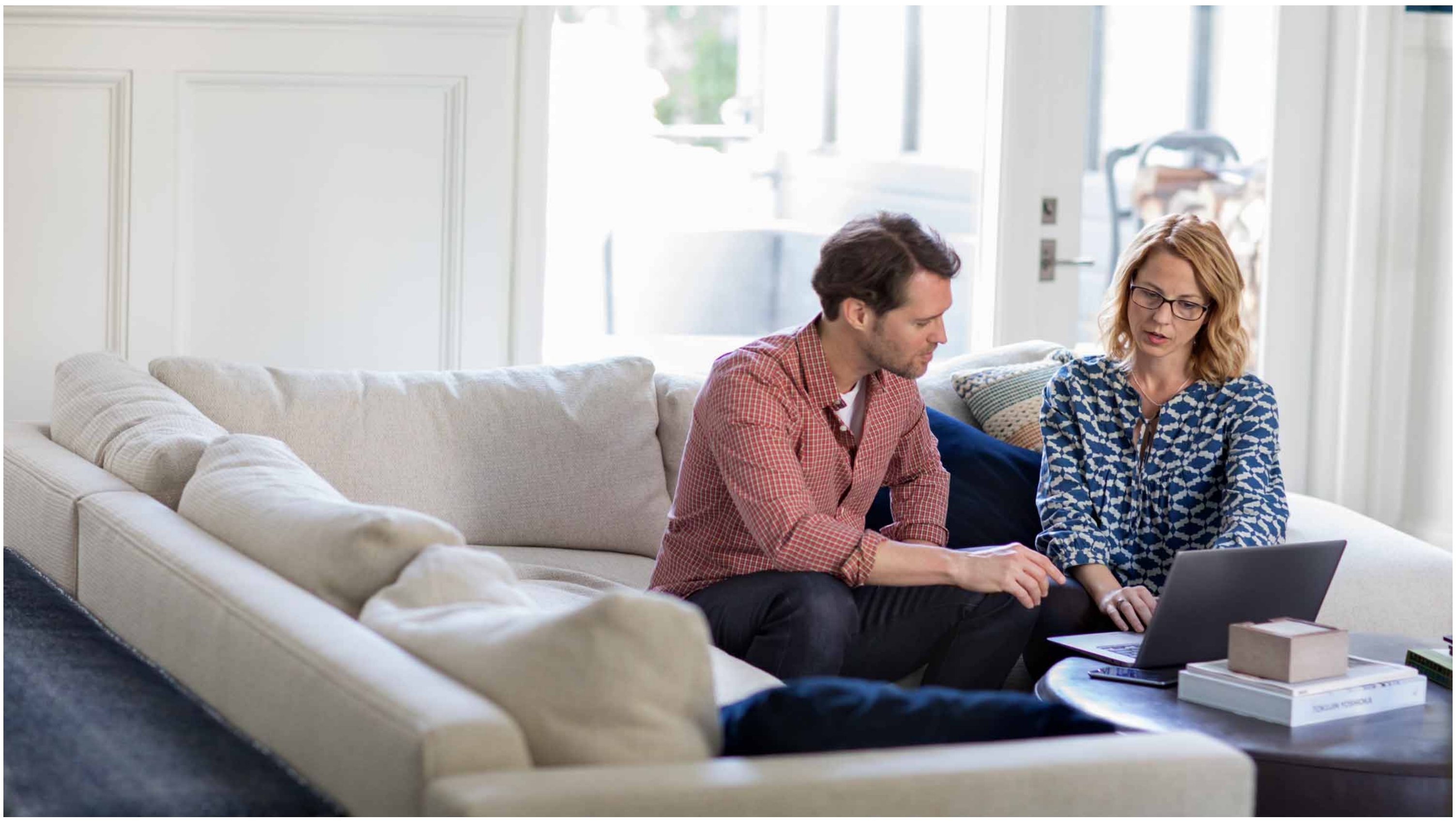
How to Put Your Financial Affairs in Order

By Rob Williams



Crises make us see the world differently. Things that seemed important yesterday can quickly become overshadowed by fast-changing events. Conversely, parts of our lives that we might have let drift can suddenly feel like priorities.

The COVID19 pandemic and related volatility in financial markets may be causing such a reordering of priorities. In fact, for investors who find themselves unsettled by the stomach-churning events of recent months, taking some time to reevaluate their priorities could feel like something of an opportunity to be seized.

The good news is that research has shown that using specific moments in time to make a fresh start can work. The idea is to create an “old me” and a “new me” where the dividing line is a particular point in time—New Year’s resolutions are a popular example, but a crisis can also work—and then using that “temporal landmark” as motivation to correct any errors.

So if this crisis has you thinking about your financial life, consider revisiting your priorities, your resources, your goals, and your tolerance for risk. Now could be the time to assess where you are and come up with a plan for where you want to go next.

Step 1: Create a budget for life

When it comes to finances, life can be viewed as cash flowing in—and out. Saving and investing during your working years, if you stick with it, should lead to a rising net worth over time, enabling you to achieve many of life’s most important goals. Drawing up a budget and net worth statement can help you create a road map and stay on track. Here are steps that can help:

- **Create a budget.** At a minimum, be sure to have a high-level budget with three things: how much you’re taking in after taxes, how much you’re spending, and how much you’re saving. If you’re not sure where your money is going, track your spending using a spreadsheet or an online budgeting tool for 30 days. Break expenses in to essentials—must-haves such as housing, utilities, food, and insurance—and non-essentials—nice-to-haves such as dining out, travel, vacations, and leisure. Determine how much money you need to cover the essentials, and how much you'd like to put away for other goals—if they don't match, look for non-essentials that can be cut or delayed. For retirement, our rule of thumb is to save 10%–15% of pre-tax income, including any match from an employer, starting in your 20s. If you delay, the amount you may need to save goes up. Add 10% for every decade you delay saving for retirement. Once you commit to an amount, consider ways you can save automatically.

- **Calculate your personal net worth annually.** It doesn't have to be complicated. Make a list of your assets (what you own) and subtract your liabilities (what you owe). Subtract the liabilities from the assets to determine your net worth. Don't panic if your net worth declines during tough market periods, such as the current bear market. What's important is to see a *general* upward trend over your earning years. If you're retired, you'll want to plan an income and distribution strategy to make your net worth last as long as necessary, and to support other objectives.
- **Project the cost of essential big-ticket items.** If you have a big expense in the near term, like college tuition or a roof repair, increase your savings and treat that money as spent. If you know that you'll need the money within a few years, keep it in relatively liquid, relatively safe investments like short-term certificates of deposit (CDs), a savings account, or money market funds

purchased within a brokerage account. If you choose to invest in a CD, make sure the term ends by the time you need the cash. If you have more than a few years, invest wisely, based on your time horizon.

- **Retired? Invest your living-expense money conservatively.** Consider keeping 12 months of living expenses after accounting for non-portfolio income sources (Social Security or a pension) in short-term CDs, an interest-bearing savings account, or a money market fund. Then keep another one to four years' worth of spending laddered in short-term bonds or invested in short-term bond funds as part of your portfolio's fixed income allocation. This helps provide the money you need in the short-term. It also allows you to invest other money for a level of growth potential that makes sense for you, while reducing the chances you'll be forced to sell more-volatile investments (like stocks) in a down market.
- **Prepare for emergencies.** If you aren't retired, we suggest creating an emergency fund with three to six months' worth of essential living expenses, set aside in a savings account. The emergency fund can help you cover unexpected-but-necessary expenses without having to sell more volatile investments.

Step 2: Manage your debt

Debt is neither inherently good nor bad—it's simply a tool. For most people, some level of debt is a practical necessity, especially to purchase an expensive long-term asset to pay back over time, such as a home. However, problems arise when debt becomes the master, not the other way around. Here's how to stay in charge.

- **Keep your total debt load manageable.** Don't confuse what you **can** borrow with what you **should** borrow. Keep the monthly costs of owning a home (principal, interest, taxes and insurance) below 28% of your pre-tax income and your total monthly debt payments (including credit cards, auto loans and mortgage payments) below 36% of your pre-tax income.
- **Eliminate high-cost, non-deductible consumer debt.** Try to pay off credit card debt and avoid borrowing to buy depreciating assets, such as cars. The cost of consumer debt adds up quickly if you carry a balance. Consider consolidating your debt in a low-rate home equity loan or line of credit (HELOC)—and have a plan and a schedule to pay it back.
- **Match repayment terms to your time horizons.** If you're likely to move within five to seven years, you could consider a shorter-maturity loan or an adjustable-rate mortgage (ARM), depending on current mortgage rates and options. Don't consider this if you think you may live in your home for longer, or may not be able to manage mortgage payment resets if interest rates or your plans change. We also don't suggest that you borrow money under the assumption that your home will automatically increase in value. Historically, long-term home appreciation has significantly lagged the total return of a diversified stock portfolio. And, for any type of debt, have a disciplined payback schedule.

Step 3: Optimize your portfolio

We all share the goal of getting better investment results. But successfully jumping in and out of the market as it rises and falls is difficult and can be counter-productive. So create a plan that will help you stay disciplined in all kinds of markets. Follow your plan and adjust it as needed. Here are ideas to help you stay focused on your goals.

- **Focus first and foremost on your overall investment mix.** After committing to a savings plan, how you invest is your next most important decision. Have a targeted asset allocation—that is, the overall mix of stocks, bonds and cash in your portfolio—that you're comfortable with, even in a down market. Make sure it's still in sync with your long-term goals, risk tolerance and time frame. The longer your time horizon, the more time you'll have to benefit from up or down markets.
- **Diversify across and within asset classes.** Diversification helps reduce risks and is a critical factor in helping you reach your goals. Mutual funds and exchange-traded funds (ETFs) are great ways to own a diversified basket of securities in just about any asset class.
- **Consider taxes.** Place relatively tax-efficient investments, like ETFs and municipal bonds, in taxable accounts and relatively tax-inefficient investments, like mutual funds and real estate investment trusts (REITs), in tax-advantaged accounts. Tax-advantaged accounts include retirement accounts, such as a traditional or Roth individual retirement account (IRA). If you

trade frequently, do so in tax-advantaged accounts to help reduce your tax bill.

- **Monitor and rebalance your portfolio as needed.** Evaluate your portfolio's performance at least twice a year using the right benchmarks. Remember, the long-term progress that you make toward your goals is more important than short-term portfolio performance. As you approach a savings goal, such as the beginning of a child's education or retirement, begin to reduce investment risk, if appropriate, so you don't have to sell more volatile investments, such as stocks, when you need them.

Step 4: Prepare for the unexpected

Risk is a part of life, particularly in investments and finance. Your financial life can be upended by all kinds of surprises—an illness, job loss, disability, death, natural disasters or pandemics. If you don't have enough assets to self-insure against major risks, make a resolution to get your insurance needs covered. Insurance helps protect against unforeseen events that don't happen often, but are expensive to manage yourself when they do. The following guidelines can help you prepare for life's unexpected moments.

- **Protect against large medical expenses with health insurance.** Select a health insurance policy that matches your needs in areas such as coverage, deductibles, co-payments and choice of medical providers. If you're in good health and don't visit the doctor often, consider a high-deductible policy to insure against the possibility of a serious illness or unexpected health-care event.

- **Purchase life insurance if you have dependents or other obligations.** First, take advantage of a group term insurance policy, if offered by your employer. These don't generally require a medical check, and can be cost-effective to provide income replacement for dependents. If you have minor children or you have large liabilities that will continue after your death for which you can't self-insure, you may need additional life insurance. Unless you have a permanent life insurance need or special circumstances, consider starting with a low-cost term life policy before a whole life policy.
- **Protect your earning power with long-term disability insurance.** The odds of becoming disabled are greater than the odds of dying young. According to the Social Security Administration, a person who turned 20 in 2019 has a 19% chance of becoming disabled before normal retirement age, and a 3% chance of dying before retirement age.[1] If you can't get adequate short- and long-term coverage through work, consider an individual policy.
- **Protect your physical assets with property-casualty insurance.** Check your homeowners and auto insurance policies to make sure your coverage and deductibles are still right for you.
- **Obtain additional liability coverage, if needed.** A personal liability "umbrella" policy is a cost-effective way to increase your liability coverage by $1 million or more, in case you're at fault in an accident or someone is injured on your property. Umbrella policies

don't cover business-related liabilities, so make sure your business is also properly insured, especially if you're in a profession with unique risks and aren't covered by an employer.

- **Consider the pros and cons of long-term-care insurance.** If you consider a long-term care policy, look for a policy that provides the right type of care and is guaranteed renewable with locked-in premium rates. Long-term care typically is most cost-effective starting at about age 50, and becomes more expensive or difficult to find, generally, after age 70. You can get independent sources of information from your state insurance commissioner. A sound retirement savings strategy is another way to plan ahead for long-term care costs.
- **Create a disaster plan for your safety and peace of mind.** Review your homeowner's or renter's policy to see what's covered and what's not. Talk to your agent about flood or earthquake insurance if either is a concern for your area. Generally, neither is included in most homeowners policies. Keep an updated video inventory of valuable household items and possessions along with any professional appraisals and estimates of replacement values in a safe place away from your home.

If you're tech-savvy, consider storing inventories and important documents on a portable hard drive. It's also a good idea to have copies of birth certificates, passports, wills, trust documents, records of home improvements and insurance policies in a small, secure "evacuation box" (the fireproof, waterproof kind you can lock is best) that you can grab in a hurry in case you have to evacuate immediately. Make sure your trusted loved ones know about this file as well, in case they need it.

Step 5: Protect your estate

An estate plan may seem like something only for the wealthy—but there are simple steps everyone should take. Without proper beneficiary designations, a will and other basic steps, the fate of your assets or minor children may be decided by attorneys and tax agencies. Taxes and attorneys' fees can eat away at these assets, and delay the distribution of assets just when your heirs need them most. Here's how to protect your estate—and your loved ones.

- **Review your beneficiaries, especially for retirement accounts, annuities and life insurance.** The beneficiary designation is your first line of defense to make your wishes for assets known and ensure that that transfer to who you want quickly. Keep information on beneficiaries up-to-date to ensure the proceeds of life insurance policies and retirement accounts are consistent with your wishes, your will and other documents
- **Update or prepare your will.** A will isn't just about transferring assets. It can provide for your dependents' support and care, and help you avoid the costs and delays associated with dying without one. It can also spell out plans to repay debts, such as a credit card or mortgage. Keep in mind that a beneficiary designation or asset titling trumps what's written in a will, so make sure all documents are consistent and reflect your desires. When writing a will, we

recommend working with an experienced lawyer or estate planning attorney.

- **Coordinate asset titling with the rest of your estate plan.** The titling of your property and non-retirement accounts can affect the ultimate disposition and taxation of your assets. Talk with an estate attorney or lawyer not only about titling of assets, such as a home or other assets, that don't have a beneficiary designation, to make sure they reflect your wishes, and are consistent with titling laws that can vary by state, but also debts.
- **Have in place durable powers of attorney for health care.** In these documents, appoint trusted and competent confidants to make decisions on your behalf if you become incapacitated.
- **Consider creating a revocable living trust.** This is especially important if your estate is large and complex, and you want to spell out how your assets should be used in detail. A living trust may not be needed for smaller estates where beneficiaries, titling and a will can be sufficient. But talk with a qualified financial planner or attorney.
- **Take care of important estate documents.** Make sure a trusted and competent family member or close friend knows the location of your important estate documents.

Taking control

We can't control what's in the headlines, but we can take steps to bring some order to our own affairs. On that note, here are a few suggestions for tackling your financial to-do list:

- **Be realistic.** Resolving to cut your spending in half or to triple your savings rate is probably just setting you up for failure.
- **Be specific with your actions and why you're doing them.** Fuzzy goals like "get my financial affairs in order" may sound nice, but they're hard to track. Some aspects of financial housecleaning can be arcane and may not inspire action. Fix this by listing your goal and why it's important for you do it.
- **Be focused.** No one is handing out a prize for creating the longest list of financial goals. You may really want to eliminate your credit card debt, save enough for that trip to Hawaii when the pandemic ends, and reduce your grocery budget by 10% by shopping smarter. But too many goals at one time can sap your ability and motivation to stick to a small number of truly achievable goals.
- **Celebrate successes.** A nice pat on the back goes a long way toward keeping you motivated and feeling confident about your ability to respond to any surprises life or the markets throw your way.

What you can do next

- Read more about Schwab's perspective on recent market volatility.
- **Schwab clients, please reach out** if you'd like discuss your portfolio. Contact your Schwab Financial Consultant or call us at 800-355-2162.
- **If you're not a client**, learn how Schwab can help you reach your goals.

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Past performance is no guarantee of future results.

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A bond ladder, depending on the types and amount of securities within the ladder, may not ensure adequate diversification of your investment portfolio. This potential lack of diversification may result in heightened volatility of the value of your portfolio. You must perform your own evaluation of whether a bond ladder and the securities held within it are consistent with your investment objective, risk tolerance and financial circumstances.

Risks of the REITs are similar to those associated with direct ownership of real estate, such as changes in real estate values and property taxes, interest rates, cash flow of underlying real estate assets, supply and demand, and the management skill and credit worthiness of the issuer.

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