Quaker Wealth Management, LLC
Daniel Roccato, MBA, CPM
President
101 West Main Street
Moorestown, NJ 08057
856-222-0110
dan@quakerwm.com
www.quakerwm.com

Tax season is over! Though it's never really over for John. Now we can enjoy our favorite time of the year! The '69 Mustang convertible is waxed, motorcycle is out of hibernation and Maggie is playing softball.

We're all headed to Houston in June for Justin's wedding. Stef will be arriving from SC, Mary Kate will be arriving from NC. Some days, we feel like travel agents but we love seeing our daughters.

In August, we'll be moving Jack to University of San Diego and Julia has already told us that she too likes California. Yikes.

Thank you for allowing us to serve you, enjoy the season, John and Dan.

Spring 2012

Lost Decade, Debt and Rice Pudding

Lost Decade for Most

The last 10 years is known as the " **lost decade"** for the stock market. As of December 31, 2011, the benchmark S&P 500 Index , a measure of the 500 largest publicly traded companies in the USA, was virtually unchanged from December 31, 2001. Though if you include **stock dividends** paid to investors, the average annual return was 2.9% (still anemic, but not a complete waste of time).

Despite the wild market gyrations of the last 10 years, the stock market basically took investors on a trip that ended where it began. No wonder many investors, especially younger ones, have sworn off investing in the stock market. Too bad.

The situation was no doubt **made worse by so-called experts** who directed investors toward "winners". History has made fools of most experts who attempt to outsmart the market by picking individual stocks.

The Science

At Rutgers, I teach several investment theories but the most relevant is "efficient markets theory". This is a fancy way of saying that stocks are always valued appropriately and therefore, it's silly to try to identify "undervalued", diamonds in the rough.

But while most folks were taken down a dark path, often led by ethically challenged advisors, savvy investors took a different path. Recognizing the **Power of Balance** , our clients ignored the herd and instead built portfolios that consisted of a variety of asset classes. They also ignored the temptation to adjust their portfolios based on "expert" predictions.

Result? Pretty impressive. An investor with a basic, but diversified portfolio consisting of 60% S&P 500 Index and 40% Barclays US Aggregate Bond Index would have earned an annual average return of 4.23% (Vanguard Group data).

Boring, But Effective

We start with **"balance"** as a fundamental principle. We then add some **"art"** by focusing on our favored investment themes (e.g. dividend stocks, inflation protected bonds, etc.).

My college students are quick to point out that this approach is **"boring"** . Guilty, as charged. They probably enroll in my courses assuming I'll give them hot stock tips.

The best tip I give them is to reduce debt (or "leverage" in Wall Street-ese). Americans are brainwashed by powerful interests (e.g. bankers), misled by experts (e.g. so called financial planners) and encouraged by the government (e.g. the mortgage "deduction) to believe debt is a virtue. Be skeptical. In this edition, we share some thoughts.

Carol's Rice Pudding

We grudgingly concede that Carol's recipes are the most loved feature in our newsletter so we'll give her some more air time. This is one our favorites:

1 cup Carolina rice, 1.5 quarts 2% milk, 1 cup sugar, raisins (optional), 1 can evaporated milk, 1 teaspoon vanilla (plus an extra dash), 2 eggs.

Boil 1 cup of rice in 3 quart saucepan for 10 minutes. Drain off water, add milk and sugar. Bring to a boil, then cook on low heat for 30 minutes. Stir constantly to avoid boiling over (this is key). Add raisins and cook for another 15 minutes stirring the whole time. Add evaporated milk, vanilla and 2 slightly beaten eggs. Cook on low heat for another 10 minutes, stirring constantly. Pour pudding into a large glass bowl and refrigerate.

Spr inkle with cinnamon and enjoy!

Should you pay off debt or should you save and invest? To find out, compare what rate of return you can earn on your investments versus the interest rate on the debt. There may be other factors that you should consider as well.

Pay Down Debt or Save and Invest?

There are certainly a variety of strategies for paying off debt, many of which can reduce how long it will take to pay off the debt and the total interest paid. But should you pay off the debt? Or should you save and invest? To find out, compare what rate of return you can earn on your investments versus the interest rate on the debt. There may be other factors that you should consider as well.

Rate of return on investments versus interest rate on debt

Probably the most common factor used to decide whether to pay off debt or to make investments is to consider whether you could earn a higher after-tax rate of return on the investments than the after-tax interest rate on the debt if you were to invest your money instead of using it to pay off the debt.

For example, say you have a credit card with a $10,000 balance on which you pay nondeductible interest of 18%. You would generally need to earn an after-tax rate of return greater than 18% to consider making an investment rather than paying off the debt. So, if you have $10,000 available to invest or pay off debt and the outlook for earning an after-tax rate of return greater than 18% isn't good, it may be better to pay off the debt than to make an investment.

On the other hand, say you have a mortgage with a $10,000 balance on which you pay deductible interest of 6%. If your income tax rate is 28%, your after-tax cost for the mortgage is only 4.32% (6% x (1 - 28%)). You would generally need to earn an after-tax rate of return greater than 4.32% to consider making an investment rather than paying off the debt. So, if you have $10,000 available to invest or pay off debt and the outlook for earning an after-tax rate of return greater than 4.32% is good, it may be better to invest the $10,000 rather than using it to pay off the debt.

Of course, it isn't an all-or-nothing choice. It may be useful to apply a strategy of paying off debts with high interest rates first, and then investing when you have a good opportunity to make investments that may earn a higher after-tax rate of return than the after-tax interest rate on the debts remaining.

Say, for example, you have a credit card with a $10,000 balance on which you pay 18% nondeductible interest. You also have a mortgage with a $10,000 balance on which you pay deductible interest of 6%, and your tax rate is 28%. So, if you have $20,000 available to invest or pay off debt, it may make sense to pay off the credit card with $10,000 and invest the remaining $10,000.

When investing, keep in mind that, in general, the higher the rate of return, the greater the risk, which can include the loss of principal. If you make investments rather than pay off debt and your investments incur losses, you may still have debts to pay, but will you have the money needed to pay them?

Some other considerations

When deciding whether to pay down debt or to save and invest, you might also consider the following.

- What are the terms of your debt? Are there any penalties for prepayment?
- Do you actually have money that you could invest? Most debts have minimum payments that must be paid each month. Failure to make the minimum payment can result in penalties, increased interest rates, and default. Are your funds needed to make those payments?
- How much debt do you have? Is it a problem? How do you feel about debt? Is it something you can easily live with or does it make you uncomfortable?
- If you say you will save the money, will you really invest it or will you spend it? If you pay off the debt, you will have assured instant savings by eliminating the need to come up with the money needed to pay the interest on the debt.
- Would you be able to borrow an additional amount, if needed, and at what interest rate, if you paid off current debt? Do you have an emergency fund, or other source of funds, that could be used if you lose your job or have a medical emergency, or would you have to borrow?
- If your employer matches your contributions in a 401(k) plan, you should generally invest in the 401(k) to get the matching contribution. For example, if your employer matches 50% of your contributions up to 6% in a 401(k) plan, getting the 50% match is like getting an instant 50% return on your contribution. In addition, there are tax advantages to investing in a 401(k) plan.

Debt Payoff Strategies

Certain debt payoff strategies can reduce the time payments must be made and the total interest paid. Before starting any debt payoff strategy (or combination of strategies), be sure you understand the terms of your debts, including any penalties for prepayment.

In these uncertain economic times, you may be thinking of reducing your debt load. There are a number of strategies for paying off debt that you might consider. However, before starting any debt payoff strategy (or combination of strategies), be sure you understand the terms of your debts, including any penalties for prepayment.

Minimum payments

You are generally required to make minimum payments on your debts, based on factors set by the lender. Failure to make the minimum payments can result in penalties, increased interest rates, and default. If you make only the minimum payments, it may take a long time to pay off the debt, and you may have to pay large amounts of interest over the life of the loan. This is especially true of credit card debt.

Your credit card statement will indicate the amount of your current monthly minimum payment. To find the minimum payment factors, you will need to review terms in your credit card contract. These terms can change over time.

For credit cards, the minimum payment is usually equal to the greater of a minimum percentage multiplied by the card's balance (plus interest on the balance, in some cases) or some minimal amount (such as $15). For example, assume you have a credit card with a current balance of $2,000, an interest rate of 18%, a minimum percentage of 2% plus interest, and a minimum amount of $15. The initial minimum payment required would be $70 [greater of ($2,000 x 2%) + ($2,000 x (18% / 12)) or $15]. If you made only the minimum payment each month, it would take you 114 months to pay off the debt, and you would pay total interest of $1,314.

For other types of loans, the minimum payment is generally the same as the regular monthly payment.

Make additional payments

Making payments in addition to your regular payments or the minimum payments can reduce the time payments must be made and the total interest paid. The additional payments could be made periodically, such as monthly, quarterly, or annually.

For example, if you made monthly payments of $100 on the credit card debt above (the initial minimum payment was $70), it would take you only 24 months to pay off the debt, and you would pay total interest of just $396.

As another example, let's assume you have a current debt on which you owe $100,000, the interest rate is 7.125%, the monthly payment is $898, and you have a remaining term of 15 years and 3 months. If you make regular payments, you will pay total interest of $62,247. However, if you pay an additional $200 each month, it will take you only 11 years to pay off the debt, and you will pay total interest of just $44,364.

Another strategy is to pay one-half of your regular monthly mortgage payment every two weeks. By the end of the year, you will have made 26 payments of one-half the monthly amount, or essentially 13 monthly payments. In other words, you will have made an extra monthly payment for the year. Furthermore, payments are made earlier than required, thus reducing the total interest you will have to pay.

Pay off highest interest rate debts first

One way to potentially optimize payment of your debt is to first make the minimum payments required for each debt, and then allocate any remaining dollars to the debts with the highest interest rates.

For example, let's assume you have two debts, you owe $10,000 on each, and each has a monthly payment of $200. The interest rate for one debt is 8%; the interest rate for the other is 18%. If you make regular payments, it will take you 94 months until both debts are paid off, and you will pay total interest of $10,827. However, if you make monthly payments of $600, with the extra $200 paying off the debt with an 18% interest rate first, it will take you only 41 months to pay off the debts, and you will pay total interest of just $4,457.

Get a debt consolidation loan

If you have multiple debts with high interest rates, it may be possible to pay off those debts by getting a debt consolidation loan. This type of loan will typically be a home equity loan. Therefore, the interest rate on it will often be much lower than the interest rates on the debts being consolidated. Furthermore, if you itemize deductions, interest paid on home equity debt of up to $100,000 is generally deductible for income tax purposes, thus reducing the effective interest rate on the debt consolidation loan even further. However, a home equity loan potentially puts your home at risk because it serves as collateral, and the lender could foreclose if you fail to repay. There also may be closing costs and other charges associated with the loan.

Note: *All examples are hypothetical and for illustrative purposes only.*

Quaker Trusted Financial Advisors
Wealth Management, LLC

Quaker Wealth Management, LLC
Daniel Roccato, MBA, CPM
101 West Main Street
Moorestown, NJ 08057

Can reducing my credit card debt actually lower my credit score?

Most lenders use an automated credit scoring system to help determine your creditworthiness. The higher your credit score, the more creditworthy you appear.

One of the factors built into credit scoring systems is your credit card balance-to-limit ratio (the amount of debt you owe compared to your total credit limit for all cards). Lenders like to see ratios indicating you're indebted for balances approximating no more than 30% of your total limit. Generally, if your balance-to-limit ratio is higher than that, then reducing your debt will improve your credit score. But how you reduce your debt can make a difference.

You may have heard that you should consolidate several credit card balances on one card with a low interest rate, then close the paid (usually higher-rate) accounts. Doing so, the claim goes, not only minimizes the risk that you'll "dig the hole" of indebtedness even deeper, it also reduces your exposure to identity theft through the fraudulent use of inactive open lines of credit.

But if you do this, you could:

- Lower your total credit limit available without lowering your total debt, thus raising your balance-to-limit ratio--and potentially lowering your credit score in the process
- Make your credit history appear shorter by canceling accounts you have had open longest--and a shorter credit history also may lower your credit score

While it makes sense to transfer balances subject to high interest rates to accounts with lower rates (and then concentrate on paying down what you owe), consider waiting to close the paid accounts. Keeping them open may actually improve your credit score by lowering your balance-to-limit ratio (since you'll have the same amount of debt, but a higher total credit limit) while maintaining the longevity of your credit history.