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January 2010

Four Money Mistakes You Can Learn From

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It's hard to know when the economy will truly recover, although there are signs that things are headed in the right direction. But if you want your own finances to stabilize over the long term, you'll need to evaluate what you've been doing right...and wrong. There's no magic bullet, but avoiding these four money mistakes may help you survive and ultimately thrive in any turbulent economy.

Mistake 1: Expecting things to stay the same

It's a familiar tale. Economic times were good. The stock market went up, up, up. Home values (and real estate prices) soared, credit was flowing, and the job market was robust. And then...the bottom fell out.

At the heart of all economic bubbles is the euphoric, yet ultimately mistaken, idea that the good times are here to stay. And when the economic news is bad, it's just as easy to assume that the tough times will remain. But your own financial recovery will ultimately depend on you not jumping on any bandwagon. Instead, take a proactive, rather than reactive, approach to financial planning, no matter what economic news you're hearing. Prepare yourself for a variety of financial scenarios and avoid basing money decisions on emotion or you may find yourself making the same financial mistakes over and over.

> "Success does not consist in never making mistakes, but in never making the same one a second time."
>
> *George Bernard Shaw*

Mistake 2: Only saving your leftovers

Do you worry that you're not saving enough? Do you routinely rely on credit rather than cash to pay for the things you want or need? Rather than blame your financial inertia on your income, look a bit deeper, because the real culprit may be the lack of financial priorities. If you don't know exactly how you're spending your money and you haven't set financial goals, it's unlikely that you'll see much financial progress.

Go back to basics by preparing (or reviewing) your budget. If you tend to save only what you have left over every month, you can put yourself on a more disciplined course by having a fixed amount taken out of your paycheck automatically toward particular financial goals. You can also set up automatic transfers from your checking account to a savings or investment account.

Mistake 3: Not having an emergency fund

One of your savings priorities should be an emergency fund. An emergency fund isn't glamorous, but this underappreciated work horse really pulls its weight during hard times. Having cash on hand that you can use for an unexpected expense, or to pay bills if you lose your job or become disabled, is vital because it can help you avoid having to rely on credit or tap your retirement savings. Without emergency savings to fall back on, worse financial trouble may lie down the road.

Mistake 4: Not asking for help

Even if your finances are in good shape right now, you may be overdue for a "checkup". A close look at your financial plan will help you identify potential strengths and weaknesses. The Certified Financial Planners at New Wealth Advisors can provide you with a very informative review of your personal cash flows, the cornerstone of a financial plan. You would be pleasantly surprised how painless and valuable this type of "checkup" can be.

About New Wealth Advisors.

New Wealth Advisors is an independent, fee-only, SEC-registered investment advisor, operating as a multi-family investment office. We work with newly wealthy individuals and families to protect, grow and manage assets.

FAQ: Paydown Mortgage or Invest?

Owning a home outright is a dream that many Americans share. Having a mortgage can be a huge burden, and paying it off may be the first item on your financial to-do list. But competing with the desire to own your home free and clear is your need to invest for retirement, your child's college education and other goals. Putting extra cash toward one of these goals may mean sacrificing another. So how do you choose?

Keeping the bigger picture in mind

Have you taken a good look at the various things you'd like to do, have and be? What are the financial requirements for these critical "life" goals? What impediment would accelerated debt pay down have against those other goals and dreams?

Evaluating the opportunity cost

Deciding between prepaying your mortgage and investing your extra cash isn't easy, because each option has advantages and disadvantages. But you can start by weighing what you'll gain financially by choosing one option against what you'll give up. In economic terms, this is known as evaluating the opportunity cost.

Here's an example. Let's assume that you have a $300,000 balance and 20 years remaining on your 30-year mortgage, and you're paying 6.25% interest. If you were to put an extra $400 toward your mortgage each month, you would save approximately $62,000 in interest, and pay off your loan almost 6 years early.

By making extra payments and saving all of that interest, you'll clearly be gaining a lot of financial ground. But before you opt to prepay your mortgage, you still have to consider what you might be giving up by doing so--the opportunity to potentially profit even more from investing.

To determine if you would come out ahead if you invested your extra cash, start by looking at the after-tax rate of return you can expect from prepaying your mortgage. This is generally less than the interest rate you're paying on your mortgage, once you take into account any tax deduction you receive for mortgage interest. Once you've calculated that figure, compare it to the after-tax return you could receive by investing your extra cash.

For example, the after-tax cost of a 6.25% mortgage would be approximately 4.5% if you were in the 28% tax bracket and were able to deduct mortgage interest on your federal income tax return. The after-tax cost might be even lower if you were also able to deduct mortgage interest on your state income tax return. Could you receive a higher after-tax rate of return if you invested your money instead of prepaying your mortgage?

Keep in mind that the rate of return you'll receive is directly related to the investments you choose. Investments with the potential for higher returns may expose you to more risk, so take this into account when making your decision.

Other points to consider

While evaluating the opportunity cost is important, you'll also need to weigh many other factors. The following list of questions may help you decide which option is best for you.

- What's your mortgage interest rate? The lower the rate on your mortgage, the greater the potential to receive a better return through investing.
- Does your mortgage have a prepayment penalty? Most mortgages don't, but check before making extra payments.
- How long do you plan to stay in your home? The main benefit of prepaying your mortgage is the amount of interest you save over the long term; if you plan to move soon, there's less value in putting more money toward your mortgage.
- Will you have the discipline to invest your extra cash rather than spend it? If not, you might be better off making extra mortgage payments.
- Do you have an emergency account to cover unexpected expenses? It doesn't make sense to make extra mortgage payments now if you'll be forced to borrow money at a possibly higher interest rate later. And keep in mind that if your financial circumstances change--if you lose your job or suffer a disability, for example--you may have more trouble borrowing against your home equity.
- How comfortable are you with debt? If you worry endlessly about it, give the emotional benefits of paying off your mortgage extra consideration.
- How will prepaying your mortgage affect your overall tax situation? For example, prepaying your mortgage (thus reducing your mortgage interest) could affect your ability to itemize deductions (this is especially true in the early years of your mortgage, when you're likely to be paying more in interest).
- How much time do you have before you reach retirement or until your children go off to college? The longer your timeframe, the more time you have to potentially grow your money by investing. Alternatively, if paying off your mortgage before reaching a financial goal will make you feel much more secure, factor that into your decision.

The middle ground

If you need to invest for an important goal, but you also want the satisfaction of paying down your mortgage, there's no reason you can't do both. It's as simple as allocating part of your available cash toward one goal, and putting the rest toward the other. Even small adjustments can make a difference. For example, you could potentially shave years off your mortgage by consistently making biweekly, instead of monthly, mortgage payments, or by putting any year-end bonuses or tax refunds toward your mortgage principal.

And remember, no matter what you decide now, you can always reprioritize your goals later to keep up with changes to your circumstances, market conditions, and interest rates.

ASK THE EXPERTS

What can affect the cost of homeowners insurance?

There are many factors that can affect the cost of homeowners insurance. Here's a description of some of the more common factors.

Generally, as your home gets older, the cost of insuring it may increase. Older homes have more things that can go wrong, often related to outdated wiring, older plumbing, or lead paint.

The location of your home also can affect your insurance premium. Insurers generally regard homes located in urban areas to be at a higher risk of burglary than comparable suburban homes, translating to a higher premium cost for metropolitan area houses. Insurance may cost more if your home is located in an area prone to a specific peril, such as floods, or in a rural area far from a fire station or fire hydrant.

Living in an area prone to claims for mold damage can increase your premium. In fact, excessive mold damage can be so costly to repair that some insurers either are significantly increasing premiums to insure mold damage, or they're eliminating coverage completely.

Rising repair or construction costs in your area also will increase your insurance premium. If it'll cost more to repair or replace your home, it'll cost more to insure it as well.

Sometimes, you can cause your insurance rates to increase. Swings, trampolines, and other backyard equipment can add to your premium. Owning a swimming pool, sauna, or hot tub may increase your property's value as well as the risk of injury or property damage, which will be reflected in your insurance bill.

Based on the breed and temperament of your dog, an insurer may consider it an increased risk of causing injury, resulting in a higher premium. If the breed of your dog is on the insurer's "bad dog list," you may not be able to get coverage for injuries caused by the dog, or your current insurance can be cancelled altogether.

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How can I reduce the cost of my homeowners insurance?

You may not have control over all of the factors that affect the cost of your homeowners insurance. But there may be some things you can do to save some money.

If your home is older, your insurer may lower your premium if you upgrade your heating, plumbing, or electrical systems to reduce the risk of fire and water damage. Let your insurer know when you've made these changes.

Selecting a larger deductible is another good way to lower your cost of insurance. You might want to put your premium savings in an emergency fund to pay the deductible, if needed.

Review your policy. You may be adding to the cost of insurance by carrying extra coverage for things that have declined in value or you no longer own, like furs or jewelry.

Swimming pools can add to the cost of insurance. However, many insurers may not increase your rates if you show them that you have safety features such as fencing or a locking gate around your pool.

Before you get a dog, check with your insurer to be sure your new pet won't increase the cost of your insurance – or cause it to be cancelled. Also, advise your insurer that you've properly trained your pet and that you've obtained all required vaccinations and tags.

Some insurers will raise your premiums if you file frequent (more than 2-3) claims of relatively small value. Try to use your insurance for major claims and consider self-insuring the rest.

Another way to save on your insurance costs is to buy your homeowners insurance and auto insurance from the same insurer. Most companies will discount the cost of insurance if you buy two or more policies from them.

You may receive a discount from your insurer by improving your home's security. Ask your insurer if adding an anti-theft system, flood lights, or even dead-bolt locks will lower your premium.

For more information or to discuss the content of this newsletter, please contact:

Jeffrey R. Arsenault, CPA/PFS, MST, CFP®, RLP®
Partner and Senior Wealth Advisor
(978) 557-5395
jarsenault@newwealthadvisors.net

New Wealth Advisors, LLC
1 Highwood Office Park
Tewksbury, MA 01876
www.newwealthadvisors.net