Planner Answers Common Personal Finance Questions

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When you're a financial planner, clients come to you with pressing personal finance questions. The same questions tend to crop up from different clients. Here are the most common ones with answers.

(Specific financial advice can be given only after considering the unique circumstances of each case. This column deals in general advice.)

How much should I be saving?

Most people should start saving at least 10% to 15% of pretax income, beginning in their 20s. If you start saving later in life, you will need to put aside a higher percentage. For example, if you start saving in your 30s, you should probably be saving 15% to 20% or more.

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Which investments should I pick in my retirement accounts?

Most people should have a mix of stocks and bonds. The younger you are, the more you probably should tilt toward stocks. As you age, it's better to increase the percentage of bonds in your portfolio.

Most employer-sponsored retirement plans, such as a 401(k), offer a set "universe" of investments from which you should pick those that are diversified and have low costs (charging less than 1% per year in fund fees).

For the average investor, target-date funds generally are a reasonable set-it-and-forget-it choice because they are diversified and have a ratio of stocks to bonds that automatically adjusts over the years in relation to the retirement date.

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When is it OK to finance a purchase through debt?

Credit card debt — always a bad idea. Having credit card debt typically is the most expensive way to “borrow” money (interest rates frequently are 18% or more) to buy things. It also wreaks havoc on your credit score. If you use a credit card, spend only money that you have and pay off your balance in full every month.

Auto loans — usually a bad idea. If you can get a very low- or zero-interest auto loan, then taking out a loan for a car is not a horrible idea. In any other situation, you should strive to buy only cars that you can pay for with cash, or else you could end up paying interest on a rapidly depreciating asset.

Student loans — sometimes a bad idea. These typically come with somewhat high interest rates and are not discharged in bankruptcy. Rates for graduate school loans, for example, are typically 6% to 7%. They are not as high as the rates on credit card debt or personal loans, but they are higher than mortgage rates, which average up to 4%, or rates on a home equity line of credit, or HELOC, which averages 4% to 5%.

So consider beforehand whether the total return on your educational investment will outweigh the significant costs of student loans.

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Mortgage debt — mostly unavoidable but OK if it’s within reason. Having a mortgage is unavoidable for most wannabe homeowners. Still, you should aim to get the lowest interest rate possible by putting a large chunk of money as a down payment and get only a mortgage that you can afford to pay back. Your monthly housing payments (mortgage, taxes and insurance) typically shouldn’t exceed 28% of your gross monthly income.

Should I use extra cash to pay down debt or invest toward retirement?

This depends on two key factors — the interest rate on the debt and your attitude toward having debt.

If the interest rate is low (4% or less), having debt doesn’t cause too much anxiety and you can get a return of more than 4%, then it isn’t a bad idea to invest extra cash toward retirement. If the interest rate is high, you should pay it off as soon as possible even if debt doesn’t negatively affect your psyche. Also, consider refinancing any high-interest debt.

If you are worried about debt, pay it off with your extra cash regardless of the interest rate. Your peace of mind is priceless.

How do I approach paying down debts?

First, consider refinancing any and all debt. Ask about the costs of refinancing, prepayment penalties and flexibility in repayment schedules for job-loss situations and other factors. If you have credit card debt, try negotiating with the card company for a lower interest rate.

If you have a lot of debt with high interest rates and have access to a line of credit or another loan at a lower interest rate, use the lower interest rate debt to pay off the higher interest rate debt in full.

If you have extra cash, start paying off your highest interest rate loan first and then move on to the next highest interest rate loan. Do not accrue any additional debt during this process.

How do I protect my family’s nest egg?

You can do that by having proper insurance coverage. If people depend on your income, you should have enough life insurance and long-term disability insurance to replace your income in case you die or become disabled.

Most people should have a personal liability umbrella policy. A car accident likely is your biggest source of potential liability. Many auto policies pay $300,000 toward damages arising from an accident, but court judgments in such cases can run into millions of dollars. A personal liability umbrella policy would cover the amount of damages that exceed your auto policy coverage (up to the policy limit).

And health insurance is a must. Injury or illness can have catastrophic financial effects if the medical costs aren't at least partially covered by insurance.

Educate yourself on personal finance matters. If you have the means, hire a financial advisor, but find one who will be a fiduciary, meaning he or she is legally bound to put your interests first.

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