Cypress Financial Planning, LLC

JULY 2013

Cypress Financial Planning
1170 Delsea Drive, Suite SF-9
Westville, NJ 08093
856.720.0029
Jeffrey Jones, CFP®
Benjamin Pitts

Market Update

(all values as of 6.28.2013)

Stock Indices:	
Dow Jones	14,909
S&P 500	1,606
Nasdaq	3,403
Bond Sector Yields:	
2 Yr Treasury	0.36%
10 Yr Treasury	2.52%
10 Yr Municipal	2.68%
High Yield	6.62%
YTD Market Returns:	
Dow Jones	13.78%
S&P 500	12.63%
Nasdaq	12.71%
MSCI-EAFE	2.18%
MSCI-Europe	.01%
MSCI-Pacific	6.37%
MSCI-Japan	15.41%
US Agg Bond	-2.44%
US Corp Bond	-3.41%
US Gov't Bond	-2.08%
Commodity Prices:	
Gold	1,224
Silver	19.47
Oil (WTI)	96.49
Currencies:	
Dollar / Euro	1.30
Dollar / Pound	1.52
Yen / Dollar	98.05
Dollar / Canadian	.98

Should We Pay Down Debt or Save for Retirement ?

The most interesting work we do at Cypress Financial Planning is helping clients solve unique problems. We enjoy scenario analyses such as: "are we better off financially by remaining in our current home and opting for private school or moving to a town with a better public school district?" "Have we saved enough to retire in three years at 55 or are we better off by taking advantage of these final prime earning/ saving years?" Questions like these contain significant financial implications and psychological factors that make the discussion very interesting and most often satisfying. These questions, the subsequent analyses, and the fascinating discussions that follow are the artifacts that makes the true financial planning process quite distinct from that of typical financial advisory.

One of the most common lines of questioning we receive from clients is "should I pay off debt or save for retirement?" Whether a primary mortgage, higher rate second mortgage, student debt, or business loans, this question comes up time and time again. Our goal is to help clients understand and quantify these decisions based on various factors. This process also helps clients come to terms with the psychological aspects of the decision as well. In the end, both decisions are helpful in securing your future.

So, should we pay down debt or save for retirement? There's no one answer that's right for everyone, but here are some of the factors we help clients consider when making their decision.

Rate of investment return versus interest rate on debt

Probably the most common way 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 by investing than the after-tax interest rate you pay on the debt. For example, say you have a credit card with a $10,000 balance on which you pay nondeductible interest of 18%. By getting rid of those interest payments, you're effectively getting an 18% return on your money. That means your money would generally need to earn an after-tax return greater than 18% to make investing a smarter choice than paying off debt. That's a pretty tough challenge even for professional investors.

And bear in mind that investment returns are anything but guaranteed. In general, the higher the rate of return, the greater the risk. If you make investments rather than pay off debt and your investments incur losses, you may still have debts to pay, but you won't have had the benefit of any gains. By contrast, the return that comes from eliminating high-interest-rate debt is a sure thing. This exercise becomes a bit more challenging when the debt is a mortgage at 6% or even 4% and it's fairly likely that investment returns can outpace those hurdles over the long term. Running the numbers becomes a bit more critical and using conservative investment return assumptions is paramount.

An employer's match may change the equation

If your employer matches a portion of your workplace retirement account contributions, that can make the debt versus savings decision more difficult. Let's say your company matches 50% of your contributions up to 6% of your salary. That means that you're earning a 50% return on that portion of your retirement account contributions. And that doesn't count any investment returns or gains from compounding you might achieve over time.

If surpassing an 18% return from paying off debt is a challenge, getting a 50% return on your money simply through investing is even tougher. The old saying about a bird in the hand being worth two in the bush applies here. Assuming you conform to your plan's requirements and your company meets its plan obligations, you know in advance what your return from the match will be; very few investments can offer the same degree of certainty. That's why many financial experts argue that saving at least enough to get any employer match for your contributions may make more sense than focusing on debt.

And don't forget the tax benefits of contributions to a workplace savings plan. By contributing pretax dollars to your plan account, you're deferring anywhere from 10% to 39.6% in taxes, depending on your federal tax rate. You're able to put money that would ordinarily go toward taxes to work immediately. That can help you take advantage of the power of time.

Your choice doesn't have to be all or nothing

The decision about whether to save for retirement or pay off debt can sometimes be affected by the type of debt you have. For example, if you itemize deductions, the interest you pay on a mortgage is generally deductible on your federal tax return. Let's say you're paying 6% on your mortgage and 18% on your credit card debt, and your employer matches 50% of your retirement account contributions. You might consider directing some of your available resources to paying off the credit card debt and some toward your retirement account in order to get the full company match, and continuing to pay the tax-deductible mortgage interest.

There's another good reason to explore ways to address both goals. Time is your best ally when saving for retirement. If you say to yourself, "I'll wait to start saving until my debts are completely paid off," you run the risk that you'll never get to that point, because your good intentions about paying off your debt may falter at some point. Putting off saving also reduces the number of years you have left to save for retirement; that weakens the power of time as a retirement savings ally.

Other considerations

When deciding whether to pay down debt or to save for retirement, make sure you take into account the following factors:

- Having retirement plan contributions automatically deducted from your paycheck eliminates the temptation to spend that money on things that might make your debt dilemma even worse. If you decide to prioritize paying down debt, make sure you put in place a mechanism that automatically directs money toward the debt--for example, having money deducted automatically from your checking account--so you won't be tempted to skip or reduce payments.

- Do you have an emergency fund or other resources that you can tap in case you lose your job or have a medical emergency? Remember that if your workplace savings plan allows loans, contributing to the plan not only means you're helping to provide a more secure retirement but also building savings that could be used as a last resort in an emergency. Some employer-sponsored retirement plans allow hardship withdrawals in certain situations--for example, payments necessary to prevent an eviction from or foreclosure of your principal residence--if you have no other resources to tap. (However, remember that the amount of any hardship withdrawal becomes taxable income, and if you aren't at least age 59½, you also may owe a 10% premature distribution tax on that money.)

- If you do need to borrow from your plan, make sure you compare the cost of using that money with other financing options, such as loans from banks, credit unions, or home equity lines.

- If you focus on retirement savings rather than paying down debt, make sure you're invested so that your return has a chance of exceeding the interest you owe on that debt. While your investments should be appropriate for your risk tolerance, if you invest too conservatively, the rate of return may not be high enough to offset the interest rate you'll continue to pay. Regardless of your choice, perhaps the most important decision you can make is to take action and develop a plan. Given the various factors this is a process and takes time but we believe it's a worthwhile pursuit, both psychologically and financially. The sooner you decide on a plan for both your debt and your need for retirement savings, the sooner you'll start to make progress toward achieving both goals.

Fixed Income Review - U.S.Bond Markets

The Fed's announcement of Q.E. eventually coming to an end elevated volatility and drove both short-term rates and long term rates higher this past month, resulting in a continued shift up of the Treasury yield curve.

Without much detail, Fed Chairman Bernanke disclosed the central bank's plan to start reducing its debt purchases from the current $85 billion per month sometime later this year. Bernanke also went on to say that all bond buying might very well end by the middle of 2014. Such bond purchases include Treasury and mortgage bonds.

The yield on the 10-year Treasury rose to a 22 month high following Bernanke's remarks. The 10-year Treasury ended the quarter at 2.52% as the markets digested the Fed's remarks.

The 30-year Treasury bond yield rose above 3.5% for the first time since September 2011, ending the quarter at a 3.52% yield.

Bernanke also mentioned that the central bank's holdings of mortgage bonds, which currently exceeds $1.2 trillion, should continue to depress yields in the mortgage bond sector with no expectation to sell any of the mortgage bond positions for sometime.

Comments by other Fed officials also influenced the markets, as Federal Reserve Bank of Richmond President Jeffrey Lacker, who dissented against additional stimulus at every Fed meeting last year, said financial markets will remain volatile as policy makers debate how and when to curtail the central bank's asset purchase program. Federal Reserve Bank of Dallas President Richard Fisher said investors shouldn't overreact to the central bank's plan to slow bond purchases. His comments were made less than a week following Ben Bernanke's announcement on slowing bond purchases.

Ironically, as bond prices fall, their yields become that much more attractive relative to their perceived risk, thus even as bonds have fallen in price these past few weeks, their yields have become more attractive. So as bond yields increase, new buyers for bonds will enter the market and buy up supply, thus alleviating some of the price declines by taking advantage of the higher yields.

Even with the Fed possibly slowing its bond buying by year-end, it does not anticipate raising key rates, such as the Fed funds rate, until 2015 at the earliest, per the release of recent Fed minutes. This would be more of a traditional process of raising rates directly, rather than by buying bonds in the marketplace.

The official FOMC minutes from the June meeting said that the central bank is prepared to increase or decrease its bond purchases according to the outlook for unemployment and inflation, known as the Fed's "dual mandates". The Fed expects unemployment to decrease to 7.2 – 7.3 percent this year, with a further drop to 6.5 – 6.8 percent in 2014.

Source: Federal Reserve

Commodities Update - Gold & Silver

Gold futures tumbled below $1,200 an ounce, extending a slump to a 34-month low, as U.S. economic data topped estimates by analysts, eroding the metal's appeal as a store of value. Gold settled the quarter at $1224 an ounce.

Gold had one of its weakest periods since 1971, when President Nixon took the U.S. off the gold standard. For the quarter, gold fell 25%, and off 28% for the year.

Silver has had its largest quarterly loss since 1980, with platinum also falling in June, as demand for these two more industrial metals declined. A combination of low inflation and a renewed concern with a slowing global economy have contributed to the decrease of industrial metals such as silver and platinum.

As an industrial metal, silver has over 10,000 commercial applications, including electronic and medical applications. Gold, on the other hand, has fewer commercial applications yet is a popular hedge against inflation and depreciating currencies.

Sources: Bloomberg

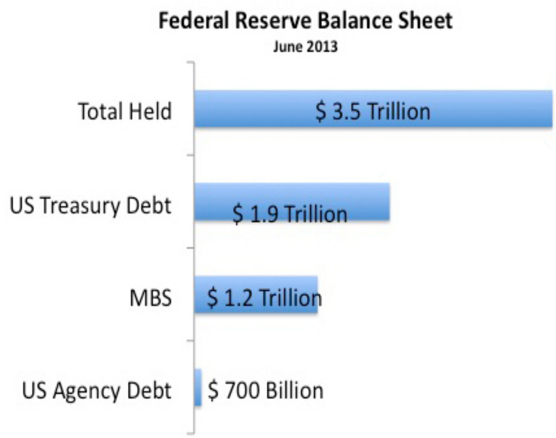
Automobile Orders Increased Over 10% In The Past Year

What The Fed Owns - Monetary Policy

The Fed's current balance sheet is now in excess of $3.5 trillion, made up of various financial instruments. Of these instruments, the largest components include U.S. Treasuries, U.S. Agency Securities, and Mortgage Back Securities (MBS).

The Fed's bond buying program, also known as quantitative easing (Q.E.) has been buying $85 billion of bonds per month in the market. This equates to over $1 trillion in purchases per year.

After having digested Bernanke's comments, the markets reacted positively the following week. Once the Fed begins to "taper" or reduce its bond buying, it would still be adding an enormous amount to the Fed balance sheet. Economists and market watchers throughout the country have estimated that the Fed may reduce its purchases to $65 billion per month from the current $85 billion per month. That's still $780 billion per year, representing about 22% of the Fed's current balance sheet. What this means is that the Federal Reserve would continue with its bond buying program in a significant way.

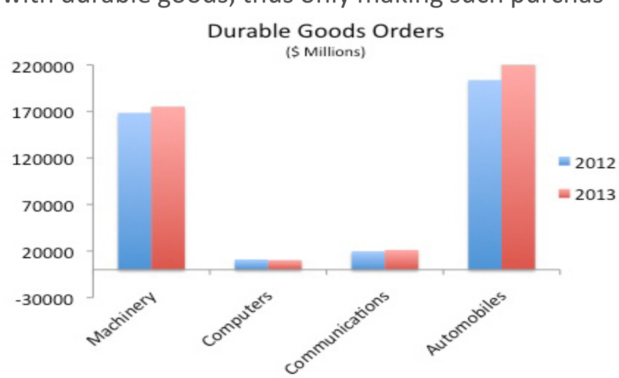


The question is, when and how will the Federal Reserve start unwinding or selling the numerous positions on its balance sheet.

Sources: Federal Reserve

Signs Of Economic Growth - Market Fact

Each month the U.S. Census Bureau releases data on new orders for durable goods, which are defined as items that have a useful life of three or more years. Orders for these longer-term goods are considered a measure of economic growth by economists. This is so, because the cost of these goods are usually much greater than the cost of consumable goods, such as toothpaste and food. Individuals and large companies alike must decide and commit to larger costs associated with durable goods, thus only making such purchases under confident and growth oriented conditions.



May data, the most recent data released, showed an increase in new orders for durable goods of 2.1% from the previous year. Capital equipment, such as machinery, saw an increase of 4.0% from last year. Interestingly enough, there was over a 6% drop in new orders for computers, yet an increase of 7.5% in new orders for communications equipment such as cell phones.

Automobile orders saw a significant increase of over 10% from May of last year. Positively, with companies spending on machinery and consumers spending on cars, the economy continues to show steady signs of growth.

Source: U.S. Census Bureau