INVESTMENT INSIGHTS

Balancing Investing and Debt

Get rid of the car payment or put money in the market? Your particular situation may determine the answer.

by Teri Cettina | Posted: August 17, 2014

When you're juggling multiple financial priorities, it can be tough to know where to focus. For instance, should you put money into things your family needs now, or save for the future? Would it be wise to concentrate on extinguishing most of your debt quickly to free up your cash flow? Or should you let your debt payments run their course, and instead focus on investing for retirement?

Theories about balancing investing and debt vary widely, depending on whom you talk to. Some financial experts say being completely debt-free is the most important goal, while others claim your money priorities should be dictated by simple math: If your investments earn you a higher rate of return than your debts cost you, your money should go toward investing.

The broader, and better, viewpoint is that money management is about balance, says Adam Holtzschue, Managing Director and Head of Lending & Banking Services for Wells Fargo Advisors. Most people need to manage their finances for both present and future needs, he says. That means paying off some debt today while at the same time investing some money with an eye on the future.

Prepare emergency reserves

You've probably heard this before, but it bears repeating, Holtzschue says, as it's one of the first rules of investment planning: "Before you begin making decisions about either long-term investing or paying off debt, it's crucial to have adequate cash reserves to prepare for life's emergencies." He suggests having more than the typically discussed three to six months' worth of reserves. "Everyone's situation is unique, but because our economy is in a prolonged recovery, a larger amount — six to nine months' worth of reserves — may be more appropriate," he says. These funds should be in traditional savings or very short-term, highly liquid, non-volatile investments.

"Pay yourself first"

If you "pay yourself first," your retirement and long-term investments should take first priority. They come before paying for life's luxuries and putting extra amounts toward debt. "Retirement savings shouldn't be what's left over at the end of the month — it should be at the top of your list," says Holtzschue. And there's really no single magic number — like putting 15% of your gross pay toward retirement savings — that works for everyone. How much you need to allocate to future goals depends on your unique objectives. Your Wells Fargo Advisors Financial Advisor can use the Envision® planning process to help you identify all of those goals, and help determine what percentage of your monthly income should go toward those future goals.

Prioritize your debts
Putting some extra money toward your debts to pay them off more quickly can also be a smart strategy — as long as you have an emergency fund and are already investing toward key future goals. But how do you decide which debts to pay down first? There are many technical, math-based strategies, taking into account the amount of debt, type of debt, interest rate, and loan term. But there's another strategy that bears consideration.

"You may also want to balance intellectual and emotional considerations when it comes to debt payoff," notes Holtzschue. "For instance, are there certain debts that would make you feel more secure by paying off sooner, or will you look at them from a purely mathematical point of view — as in, which debts carry the highest interest rate or the most risk?"

Those are great questions to discuss with your Financial Advisor. Generally, it may make sense to pay off debts like private student loans and credit card debt more quickly, because their interest rates are usually higher. Federal student loans and mortgages might be lower priorities, because their rates are often lower and their terms are longer. Vehicle loans might fall somewhere in the middle. Tax considerations might also come into play. "Although the interest rate might be low, paying off a car loan can free up a large amount of cash flow quickly that you can then use for investing or repaying other obligations," notes Holtzschue.

"A good Financial Advisor will help you look at both sides of your balance sheet — both your assets and your debts," says Holtzschue. Your advisor can also help you find that balance point in your investment plan — where your debts should begin to move steadily downward while your savings and investments move upward. That "sweet spot" can be your ticket to helping to afford the lifestyle you've always envisioned, whether it's now or in retirement.

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ADDITIONAL RESOURCES

Once you've made the decision to invest, it's important to make sure you have a diverse portfolio. Learn more about "Investing Outside Your Comfort Zone." (https://lifescapes.wfmagazines.com/plan_invest/investment_insights/article/investing_comfort_zone/)

Investments and Insurance Products:

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