Registered Investment Advisor Firm

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Teach Sound Savings

If you have a child or grandchild that has recently graduated from high school or college and left home for a full-time job with a steady paycheck, congratulations! Make sure you take some credit in your child or grandchild's early success.

Now that we've patted ourselves on the back, we have more yet to do. If we want the young adults in our life to follow that initial step of finding a job and moving toward complete, sustainable financial independence, we need to guide them further on a number of vital lessons as soon as their paychecks start hitting their bank accounts.

Helping loved ones get an early start on practical money management is a gift that can last a lifetime and unfortunately it's not something that is widely covered in high school or college curricula.

Here are several suggestions you may wish to share with your children or grandchildren to set them on their journey to a sound financial future.

Don't be afraid to start a discussion. Think back to when you were you were single, just trying to make ends meet.

It's probably a good guess that no one took the time to tell you about the importance of, or how to manage your money. Knowing what you do today, wouldn't you have welcomed such advice?

Here's your opportunity to have that conversation with your child or grandchild about basic principles and practices to help make saving and investing become a habit. The sooner they learn this lesson the better their financial position will be years from now.

Having children at this age, I know that they are not always open to unsolicited advice, so some general, non-intrusive questions might help you to open the lines of communication. You might consider asking questions along the lines of:

--Does your new job offer a 401(k) plan?
--Do you plan to buy a car or home in the near future?
--What's your approach to managing credit card debt?

These are fairly broad in scope, but remember the mission is to initiate a dialogue so you can impart your wisdom in a meaningful and congruent way. Our advice won't work unless it's received in a way and manner that resonates.

Understand where the money goes.
To help get a handle on their financial reality, suggest that they track their expenses for a couple of months to determine exactly where their money goes. There are a number of free smartphone apps and websites that can help with his process, so it shouldn't be too painful to implement.

The tracking should include the obvious like rent and utilities, as well as cash expenditures on food, coffee, entertainment and other everyday purchases.

Tracking daily, weekly and monthly spending can be a real eye-opener for anyone making their own money for the first time.

Tracking is generally required before a discipline can be effectively implemented to cut back on unnecessary expenditures and start to build an "emergency fund." While we're at it, the "emergency fund" is not for something that just went on sale!

Plastic is convenient but use with CAUTION!

Credit cards offer a convenient way to make purchases, however credit and responsibility go hand-in-hand.

As of September 2014, the average American household held about $15,607 in credit card debt and was paying it back at interest rates in the mid to high teens, according to Federal Reserve data.

We need to encourage our children or grandchildren to avoid the "minimum-payment" trap by showing them how to read a credit card statement.

Fortunately, these statements must now disclose how long it will take and how much it will cost in interest to pay just the minimum balance each month to clear the debt.

Obviously late fees from missed payments and the impact on one's credit score are also valuable discussions to have.

Student loans, the chicken or the egg?
Maybe not one of the greatest debates, but important none the less.

If your child or grandchild is a college graduate, aside from monthly rent and potential car payments, student loans may be among your child's largest expenses.

Unfortunately there are no real shortcuts when it comes to paying off college-loan debt, other than potentially consolidating several loans into one to obtain a lower interest rate.

In some instances, it may make sense to first pay off college loans with high interest rates rather than saving money in a low-interest-rate vehicle, such as a money market fund (emergency funds excepted).

A solid credit score builds a strong foundation. Responsible spending advances long-term benefits by allowing anyone just starting out to build a solid credit history.

It's critically important to understand how credit scores are affected and why a good score is important to maintain. You may also want to mention that employers frequently examine applicants' credit histories as part of their background checks.

There are many factors that affect the scores, including making payments on time, the number of accounts maintained, late payments, outstanding debt and any collection actions brought.

Under federal law, everyone has the right to receive a free copy of their credit report once a year from the three nationwide credit reporting companies—Equifax, Experian and TransUnion. You can access your free report at www.annualcreditreport.com.

Ready, set GO! For anyone in their early 20s, retirement may seem like a remote concept, if it hits their radar at all.

But we know better. While most young people do not have a lot of extra cash to invest, they have the great equalizer on their side – TIME. Even a delay of only a few years can make a big difference in their retirement savings when it comes time to cash in.

To highlight the power of compounding over time, consider a 20-year-old who sets aside $1,000 a year in an IRA and stops investing at age 30. They invested a total of $10,000. By the age of 65, they would accumulated $157,838, assuming a 7% return compounded annually.

Now let's consider a 30-year-old who invests $1,000 a year for the next 35 years, a total contribution of $35,000. Assuming the same rate of return, by age 65 they would have accumulated $148,913. That's $8,925 less than the person that only invested $10,000 over a 10 year period then stopped investing.

TAKE ACTION. The sooner your child or grandchild begins the journey toward financial independence, the better for both you and them.

You have a role in this process by promoting the value of early budgeting and investing. If you don't feel you have the skills or knowledge necessary to get your loved ones on track, I encourage you to put them in touch with a trusted financial professional who can help them (and maybe even yourself) establish a plan for a fiscally sound future.

Answer Forum

I only received one question this month and it involved dusting off the crystal ball. Essentially it asked what did I expect to see happen when the Fed begins to raise rates. First of all, I'm not in the forecasting business, but I can share some thoughts.

The Fed controls short-term rates and when they decide it's time to begin the process of raising rates, I believe the path they take will be the most important factor.

For instance, will they decide to raise rates gradually over an extended period of time, or hold back, ready to move quickly with larger increases over a shorter period of time than the markets anticipate?

Because we are in uncharted territory, history and economic models are not a reliable indicator.

The Fed will undoubtedly study and debate the pros and cons of financial stability by keeping rates depressed and how it could cause the credit markets to overheat.

I would also expect them to consider the mechanics of the rate increases. Their past practices probably won't work because they've pumped so much money into the financial markets, just raising overnight lending rates between banks may not be an option.

By starting early and gradually, the Fed runs a greater chance of getting or staying ahead of inflation. This will produce the greatest flexibility.

Once rates do start to officially move up, you could see an exodus from fixed income looking for a new place to park. I wouldn't immediately assume any rate increase to be overly detrimental to the equity markets. NOT A PREDICTION.

Please keep your questions coming, together we can help make this newsletter more educational and beneficial to all.

Davis Investment Group

Davis Investment Group is a fee-based Registered Investment Advisor firm servicing the needs of clients across the United States.

Davis Investment Group custodies all client assets at Charles Schwab & Co. Davis Investment Group's home office is located at 714 Marin Street, Suite #C, Vallejo, CA 94590. The telephone number is (707) 648-2024.

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