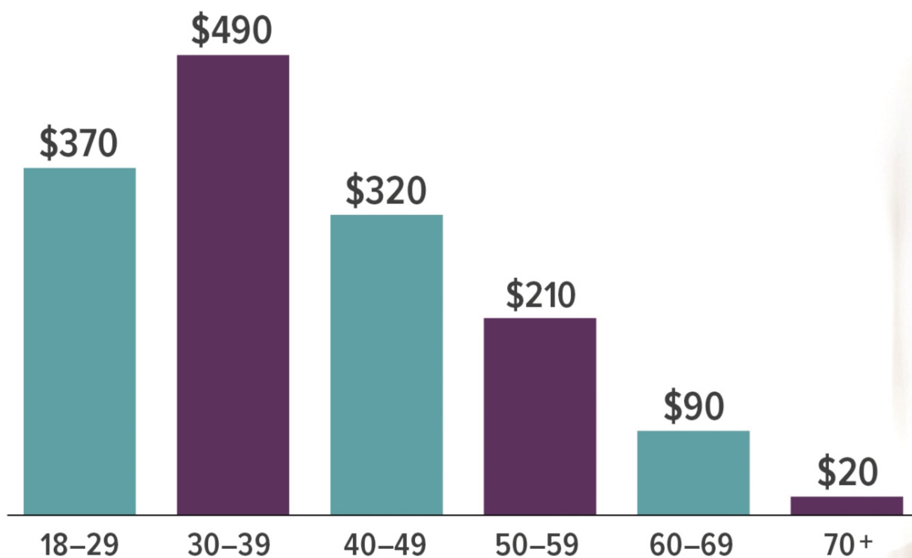
Focus on Financial FItness

Linden Financial Group
108 Main Street • Amesbury • MA • 01913
978-388-3468 • 978-388-3468
plan@lindenfinancialgroup.com • LindenFinancialGroup.com

Student Debt: It's Not Just for Young Adults

Recent college graduates aren't the only ones carrying student loan debt. A significant number of older Americans have student debt, too. In fact, student loan debt is the second-highest consumer debt category after mortgage debt. In total, outstanding student loan debt in the United States now stands at approximately $1.5 trillion, with the age 30 to 39 group carrying the highest load.



Source: New York Fed Consumer Credit Panel/Equifax (Q3 2019 data)

Investor Psychology: Behavioral Biases That Can Lead to Costly Mistakes

The field of behavioral finance focuses on the emotional and cognitive aspects of investing. In recent decades, well-known economists have advanced the theory that investors' decisions can be driven by human emotions such as greed and fear, which helps explain why asset prices sometimes fluctuate erratically.[1]

It can be difficult to act rationally when your financial future is at stake, especially when unexpected events upset the markets. But understanding certain aspects of human nature, and your own vulnerabilities, might help you stay levelheaded in the heat of the moment.

Every investment decision should take your financial goals, time horizon, and risk tolerance into account. That's why it's important to slow down and try to consider all relevant factors and possible outcomes.

Here are six behavioral biases, which could also be called mental shortcuts or blind spots, that might lead you to make regrettable portfolio decisions.

1. Herd mentality. Many people can be convinced by their peers to follow trends, even if it's not in their own best interests. When investors chase returns and follow the herd into "hot" investments, it can drive up prices to unsustainable levels and create asset bubbles that eventually burst. Joining the crowd and fleeing the stock market after it falls, and/or waiting too long (until prices have already risen) to reinvest, could harm your long-term portfolio returns.

2. Availability bias. People tend to base their judgments on information that immediately comes to mind. This could cause you to miscalculate risks or expected returns. In the same way that watching a movie about sharks can make it seem more dangerous to swim in the ocean, a recent news article can shape how you perceive the quality of an investment opportunity.

3. Confirmation bias. People also have a tendency to search out and remember information that confirms, rather than challenges, their current beliefs. If you have a good feeling about a certain investment, you may be more likely to ignore critical facts and focus on data that supports your opinion.

4. Overconfidence. Some individuals overestimate their skills, knowledge, and ability to predict probable outcomes. When it comes to investing, overconfidence may cause you to trade excessively and/or downplay potential risks.

5. Loss aversion. Many investors dislike losses much more than they enjoy gains. Because it actually feels bad to experience a financial loss, you might avoid selling an investment that would realize a loss, even though it might be an appropriate course of action. An intense fear of losing money may even be paralyzing.

Market Moods

Retirees and higher-net-worth investors were more likely than other groups to say that their daily mood is sensitive to changes in their investment portfolios. The following chart illustrates the percentage of U.S. investors who say the performance of their investments affects their daily mood (a little or a lot).

Source: Gallup, 2019

6. Anchoring effect. When making decisions, people often depend heavily on the first information they receive, then adjust from that starting point based on new data. For investors, this translates into placing too much emphasis on an initial value (or purchase price) or on recent market performance. Investors who were "anchored" to the financial crisis may still be fearful of the stock market, even after years of strong returns. Another investor who has only experienced years of gains might be inclined to take on too much risk.

Even the most experienced investors can fall into these psychological traps. Having a long-term perspective and a thoughtfully crafted investing strategy may help you avoid expensive, emotion-driven mistakes. It might also be wise to consult an objective third party, such as a qualified financial professional, who can help you detect any biases that may be clouding your judgment.

All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful. Although there is no assurance that working with a financial professional will improve investment results, a financial professional can provide education, identify strategies, and help you consider options that could have a substantial effect on your long-term financial prospects.

1) "From Efficient Markets Theory to Behavioral Finance," *Journal of Economic Perspectives* , Winter 2003

Managing Your Workplace Retirement Plans

About 80 million Americans actively participate in employer-sponsored defined contribution plans such as 401(k), 403(b), and 457(b) plans.[1] If you are among this group, you've taken a big step on the road to retirement, but as with any investment, it's important that you understand your plan and what it can do for you. Here are a few ways to make the most of this workplace benefit.

Take the free money. Many companies match a percentage of employee contributions, so at a minimum you may want to save enough to receive a full company match and any available profit sharing. Some workplace plans have a vesting policy, requiring that workers be employed by the company for a certain period of time before they can keep the matching funds. Even if you meet the basic vesting period, funds contributed by your employer during a given year might not be vested unless you work until the end of that year. Be sure you understand these rules if you decide to leave your current employer.

Reasons to Contribute

Percentage of households with assets in defined contribution plans who agreed with the following statements

Payroll deduction makes it easier for me to save

92%

My employer-sponsored retirement plan helps me think about the long term, not just my current needs

91%

My employer-sponsored retirement plan offers me a good lineup of investment options

83%

The tax treatment of my retirement plan is a big incentive to contribute

82%

Source: Investment Company Institute, 2018

Bump up your contributions. Saving at least 10% to 15% of your salary for retirement (including any matching funds) is a typical guideline, but your personal target could be more or less depending on your income and expenses. A traditional employer-sponsored plan lets you defer income taxes on the money you save for retirement, which could enable you to save more. In 2020, the maximum employee contribution to a 401(k), 403(b), or 457(b) plan is $19,500 ($26,000 for those age 50 and older).[2] Some plans offer an automatic escalation feature that increases contributions by 1% each year, up to a certain percentage.

Rebalance periodically. Your asset allocation — the percentage of your portfolio dedicated to certain types of investments — should generally be based on your risk tolerance and your planned retirement timeline. But the allocation of your investments can drift over time due to market performance. Rebalancing (selling some investments to buy others) returns a portfolio to its original risk profile and does not incur a tax liability when done inside a retirement plan. Consider reviewing your portfolio at least annually. Some workplace plans offer automatic rebalancing.

Know your investments. Examine your investment options and choose according to your personal situation and preferences; some employer-sponsored plans may automatically set up new employees in default investments. Many plans have a limited number of options that may not suit all of your needs and objectives, so you might want to invest additional funds outside of your workplace plan. If you do, consider the risk and overall balance of your portfolio, including investments inside and outside your plan.

Keep your portfolio working. Some employer plans allow you to borrow from your account. It is generally not wise to use this option, but if you must do so, try to pay back your loan as soon as possible in order to give your investments the potential to grow. Plans typically have a five-year maximum repayment period.

All investments are subject to market fluctuation, risk, and loss of principal. When sold, investments may be worth more or less than their original cost. Asset allocation is a method used to help manage investment risk; it does not guarantee a profit or protect against investment loss. Distributions from employer-sponsored retirement plans are generally taxed as ordinary income. Withdrawals prior to age 59½ may be subject to a 10% federal income tax penalty.

1) American Benefits Council, 2019

2) Employer contributions are not included in these annual employee limits for 401(k) and 403(b) plans. Employers typically do not contribute to 457(b) plans, but any such contributions will count toward the employee limit. There may be additional catch-up contribution opportunities for 403(b) and 457(b) plans.

The ABCs of Finance: Teaching Kids About Money

It's never too soon to start teaching children about money. Whether they're tagging along with you to the grocery store or watching you make purchases online, children quickly realize that we use money to buy the things we want. You can teach some simple lessons today that will give them a solid foundation for making a lifetime of sound financial decisions.

Start with an Allowance. An allowance is often a child's first brush with financial independence and a good way to begin learning how to save money and budget for the things they want. How much you give your children will depend in part on what you expect them to buy and how much you want them to save. Make allowance day a routine, like payday, by giving them a set amount on the same day each week or month.

Help Them Set Financial Goals. Children might not always appreciate the value of putting money away for the future. Help them set age-appropriate short- and long-term financial goals that will serve as incentives for saving money. Write down each goal and the amount that must be saved each day, week, or month to reach it.

> *Teach younger children some simple lessons today that will give them a solid foundation for making a lifetime of sound financial decisions.*

Let Them Practice. As children get older, they can become more responsible for paying other expenses (e.g., clothing, entertainment). The possibility of running out of money between allowance days might make them think more carefully about their spending habits and choices and encourage them to budget more effectively.

Take It to the Bank. Piggy banks are a great way to start teaching young children to save money, but opening a bank savings account will reinforce lessons on basic investing principles such as earning interest and the power of compounding. Encourage your children to deposit a portion of any money they receive from an allowance, gift, or job into their accounts.

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