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WEALTHYMINDS

INSIGHTS FOR YOUR FINANCIAL WELL-BEING

GOOD FINANCIAL HABITS DIE HARD— AND THAT'S A GOOD THING

People's United Advisors®

GOOD FINANCIAL HABITS DIE HARD— AND THAT'S A GOOD THING

START SMALL

Don't bite off more than you can chew, either in the number of habits you try to adopt or the specific goals you set.

T'S SAID, "OLD HABITS DIE HARD", an adage about the difficulty of ridding oneself of bad repetitive behavior. But the flip side of the coin is that good habits also stay with us. If you're trying to set yourself up for long-term security and success—and who isn't? —the persistence of good financial habits will work to your advantage. It's especially appropriate to think about building some of those habits in the early months of a new year, when resolutions are in style.

What Is a Habit?

First we'd distinguish between a habit and a new year's resolution. Resolutions are well-intentioned, but too often they're overly broad, unattached to an implementation plan, and not responsive to who you are. Habits, by contrast, are focused, practical, and designed to fit the best vision of yourself.

Pulitzer-Prize-winning journalist Charles Duhigg identified three components of a habit[1]:

- A *cue*, which triggers the habit (for regular saving, e.g., seeing the calendar turn to a new month or receiving a paycheck);
- The *response*, the behavioral action that follows (e.g., depositing your savings into an account you've set up for the purpose); and
- A *reward* for engaging in the behavior: an increase in pleasure or a decrease in discomfort (e.g., the satisfaction you get from seeing your savings grow, perhaps even accompanied by a small tangible award you give yourself for having been "good").

As this loop plays out over and over, the response becomes reliable and automatic—some behavioral scientists say subconscious. And the more unthinking the response, the better. For one thing, we don't want to rely overly on willpower. Willpower is a fine trait, but we tend to overestimate its power: If we tax it too much, we'll revert to our old slipshod ways—so the better route is to bypass willpower early in the game with automatic, repeated action.[2] The more a good action is repeated, the more ingrained it becomes.

But as many commentators have advised, *start small*.[3] Don't bite off more than you can chew, either in the number of habits you try to adopt or the specific goals you set. Don't give up if you fall short once or twice; it's virtually inevitable. And like everything else financial, *plan* for how you'll implement your new habits and how they'll fit into your overall financial objectives. Winging it is a recipe for failure.

With that as a background, we're highlighting a set of good financial habits in this paper, and the different shapes they take across multi-generational demographics. Regardless of your age, there is a way to make these habits automatic for you.

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1. For a synopsis of Duhigg's seminal study on habits, see https://fastertomaster.com/the-power-of-habit-by-charles-duhigg/

2. https://www.theguardian.com/lifeand-style/2017/dec/29/anyone-can-change-any-habit-science-keeping-2018-resolutions

3. See, for example, https://liveboldandbloom.com/12/habits/how-to-make-good-habits-stick

GOOD FINANCIAL HABITS DIE HARD—AND THAT'S A GOOD THING

TWO KEY HABITS TO ENSURE YOUR FINANCIAL SAFETY

Maintain adequate insurance. This may encompass life, health, property, auto, and more

Maintain a cash emergency fund, enough to support your lifestyle for at least six months, since one never knows what's around the corner.

Protection Comes First

The first rule for achieving financial security and success is making sure that you and your loved ones are financially safe. Safety can be enhanced by many habits; we'll focus on two. The first is **maintaining adequate insurance**—which may encompass life, health, property, auto, and more. But (like so much else in finance), insurance is notoriously complicated.

Life insurance, for example, is available in term and permanent-life policies. The former provides only a death benefit for a fixed term—often renewable, but for a higher premium. Most permanent-life policies (among them the popular whole-life offerings) protect for the entire lifetime of the insured and also accrue cash value, a portion of which can be borrowed, invested elsewhere, or sometimes used to pay premiums.

The second safety-first habit that we'd encourage is **maintaining a cash emergency fund** large enough to support your lifestyle for at least six months, since one never knows what's around the corner. And it's equally important to get in the habit of *replenishing* that fund as soon as possible after it's accessed. These habits shouldn't differ from generation to generation: Whether you're 25 or 85, maintaining an emergency fund should happen automatically. But a Charles Schwab survey reported in *Barron's* found that 36% of today's Millennials have no savings for emergencies.[4] That raises a huge red flag.

The situation with insurance is much more nuanced. All generations need the protection of health insurance, though for working Millennials, Gen Xers, and younger Baby Boomers, it's often provided by employers. But more protection is needed with increasing age: Gen Xers are well advised to consider buying long-term care insurance and catastrophic-illness coverage, which are typically unavailable or prohibitively expensive for Boomers. Life insurance is almost always cheaper for younger buyers, but Millennials may be better off waiting a bit and using any extra money for savings and investments. Boomers, meanwhile, often find that they no longer need their life insurance because they've provided for loved ones adequately through savings or legacy funds. If they own permanent life policies, they may choose to sell them, albeit typically at a very steep discount to face value. As for property, casualty, auto, and private-business insurance, the key is whether it's needed or not, regardless of age. The take-away is that **evaluating, and re-evaluating, your insurance needs** should become a habit whether you're starting out, in retirement, or in-between.

4. Sarah Max, "Teaching Your Kids Common Cents," *Barron's* "Special Report: Strategies for Your Kids' Cash," December 2, 2019; the report was included in the December 10, 2019, *Wall Street Journal*.

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DON'T THROW AWAY FREE MONEY!

If your employer matches your contributions up to a point, contribute at least up to that level. If not, you're throwing away free money.

Automate Your Saving

Once you've established the foundation for financial security by assuring the safety of Numero Uno and your family, the next worthy habit is **saving as much as you can, starting as early as you can**. The amount you save matters less, especially in the early years, than establishing a savings routine. If you start saving $100 each month—not a lot—when you're 25 and your money compounds at 6% per year, when you're 65 you'll have $73,450. If you begin 10 years later, you'll wind up with a bit over $55,000. Neither of these sums would be enough to fund a retirement in the absence of a healthy pension, but the difference between them is significant. We'd also note that it's better to save $100 each month than $1,200 once per year. Saving every month reinforces the habit and makes it less likely that you'll abandon it. And the more you can automate the saving process the better—for example, by setting up deductions from your paycheck into your savings account.

A special case is contributing to a retirement plan without fail, hopefully via automatic payroll deductions if you're working and your employer offers a 401(k) or similar plan. If your employer matches your contributions up to a point, contribute at least up to that level. If not, you're throwing away free money.

How much should you save? That depends on too many things to list here, including your age, the needs of your family, your health, and your overall net worth. One rule of thumb is to save 10-15% of your discretionary income each year (what you have left over after spending on necessary items and taxes), if you can swing it. If that's too aggressive a goal for you, starting at even 5% and increasing the amount by one percentage point each year—5%, then 6% the next year, and so on—may be more palatable. While the amount saved will probably be largest for Gen Xers, who are in their prime earning years, this financial habit should begin before then, and continue among younger Boomers. (Beyond that point, saving often takes a back seat to retirement spending—though it's *never* too late to start saving.)

Get Rid of "Bad" Debt

The distinction between "good debt" and "bad debt" is well known. The former—such as student loans and home mortgages—helps promote well-being or success for you or loved ones. The latter is typified by debt owed on high-interest credit cards. The habit here should be to **pay off those high-interest loans, and fast, to the extent possible**. The average credit-card rate in mid-2019 was 15.1% for existing accounts, and much higher for new offers[5]—even with Treasury-bond yields in the low single digits and inflation hovering around 2%. And though you've heard it again and again, don't make just the minimum payment each month: You'll be trapped in credit-card debt for a long time.

As to paying off good debt early, the most important factor is whether you could do better by investing the money instead. But don't discount the psychological benefit of freeing yourself from debt. Of course, you can earmark some of your funds for

5. https://wallethub.com/edu/cc/average-credit-card-interest-rate/50841/

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debt repayment and other funds for investing. But even if you decide not to pay off early, make it a habit to check the prevailing rates to see if you might refinance (for mortgages and sometimes credit cards; it's not an option for federal student loans). If you do choose to prepay, make sure there's no penalty attached, though that's never the case for either federal or private student loans. For Millennials, who are first building their lives, evaluating the trade-offs between paying off debt early and putting the funds to other uses can be particularly challenging. That's one reason out of many why seeking professional guidance can be so helpful.

The take-home habit here? For every generation, keep track of your debt at least every month and ideally with every purchase you choose (or worse, need) to pay out over time. And monitor interest rates.

Spend Prudently (No Surprise About That)

If saving early and often is a powerful financial habit to cultivate, **cutting your spending** is the other side of that coin. We're not talking about making big changes to your lifestyle—unless your spending is way off the chart—but rather trimming around the edges. *Don't* try to eliminate activities that you truly love (unless it's shopping in Tiffany's every week): You'll undoubtedly go back to them.

So what *should* you do?

- Prepare a budget and stick to it.
- Shop with a list to avoid impulse buying.
- Reduce restaurant visits (which can deplete funds quickly).
- Distinguish between what you want and what you need.
- Try to live below your means; that can really pay off in future years.

Although these good habits apply to all spenders, they're particularly important for Millennials, who need to save and invest as early as possible, and for Boomers approaching or already in retirement.

The retirement years can be scary to contemplate: In the absence of a defined-benefit pension (a perk that's becoming obsolete), a retiree has to rely on the funds that he or she has accumulated plus Social Security, which almost never can be enough by itself. Planning is the key here, both before and in retirement—including planning for a long life and poor investment markets: Better to be positively surprised than left without money. The old guideline of spending 4% of your investment portfolio when you start retirement, increased annually to account for inflation, may still work. But spending 3% may be more prudent, especially if you're hoping to leave a legacy to family and/or charity.

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TIME MATTERS.

Although these good habits apply to all spenders, they're particularly important for Millennials, who need to save and invest as early as possible, and for Boomers approaching or already in retirement.

GOOD FINANCIAL HABITS DIE HARD— AND THAT'S A GOOD THING

BE AN INVESTOR

Every day that you are invested in the market is a day that your money is put to work for you. Become financially secure. Investors can be emotional, reacting based on behavioral biases. By missing out on just the 10 best days in the U.S. stock market out of the past 30 years, investors would cut their wealth in half.

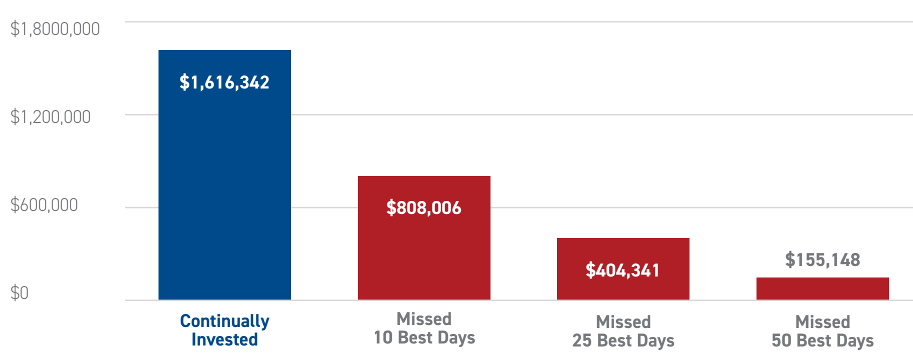
Investing Habit #1: *Remain* in the Market

Wouldn't it be great if you could get out of the stock market right before a major downdraft and get back in just as the market was recovering? Indeed it would be. The problem is, no one can foretell market turns. Worse news for market-timers, returns have tended to come in quick bursts. As *Exhibit 1* shows, if you missed just the 10 best days for the S&P 500 in roughly the last 30 years, your ending portfolio value would be cut in half. If you missed the best 25 days, your wealth would be cut in half again.

EXHIBIT 1:

MARKET-TIMING DOESN'T WORK:
YOU NEED TO STAY IN THE MARKET OVER THE LONG HAUL

Value of $100,000 invested in the S&P 500 Index 30 years ended 9/30/19*



True, if you missed the 10 *worst* days, you'd have seen stellar results. But many of them occurred soon after great days, so you'd have been out of the market in many of the best days too. The larger point is that the market is unpredictable—and to be a successful market-timer, you'd have to call the turns in both directions, knowing when to get out and when to get back in. In our judgment, it's better by far to identify, with the help of an expert, the mix of investment assets that's right for you, and then **stay pat unless and until your situation changes**. For all age cohorts, this is a good habit to cultivate—actually, a few habits rolled into one: stay invested, seek professional guidance, and monitor your needs. It's hard to practice holding still, since you'll want to make moves. But resist the impulse.

The corollary: Adopt a long-term investment perspective. Get in the habit of **not looking at your portfolio value every day or every week**. If you can hold out, do annual or semiannual reviews.

*This hypothetical example does not represent the returns of any particular investment and includes the reinvestment of dividends. Fees and expenses that apply to continued investments are excluded. Past performance does not guarantee future results.

Source: Gerstein Fisher Research., data from 9/30/89 through 9/30/2019.

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WIDEN YOUR GROWTH PLAN.

Consider a broader basket of investment styles and strategies as you focus on your growth objectives.

Investing Habit #2: Stay Diversified

Different investment assets serve different needs. Stocks, for example, tend to grow in value nicely over time, but at the cost of short-term volatility. Bonds are much more stable, and they produce regular income, but they're typically slow-growers. Cash investments usually grow even less, and should be seen as a short-run safety play. But too much of that "safety" will make long-term security impossible.

As important, the behavior of any asset class is unpredictable over short time periods. That's why it's a good idea to not put your eggs into one basket—including U.S. assets—but rather **hold onto a globally diversified mix**. When one asset class is performing poorly, another will do better, providing some insulation against risk. *Exhibit 2* shows how this worked over the 10 calendar years ending 2018.

EXHIBIT 2:

INVESTMENT WINNERS AND LOSERS CHANGE HANDS FREQUENTLY, SO IT'S BEST TO OWN A DIVERSE PORTFOLIO

Annual Returns of Asset Indexes: 2009-2018 (%)*

- **Russell 1000 Growth** US Large-Cap Growth
- **Barclays US Agregate** US Gov't, corporate & MBS
- **S&P 500** US Large-Cap Stocks
- **Russell 1000 Value** US Large-Cap Value
- **MSCI EM** Global Emerging Markets
- **MSCI EAFE** Developed Europe, Australasia & Far East
- **Barclay's High Yield** Non-Investment-Grade Taxable Corporate Bonds

Returns	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Highest	78.5	18.9	7.8	18.2	33.5	13.7	5.7	17.3	37.3	0.0
	58.2	16.7	5.0	17.5	32.5	13.5	1.4	17.1	30.2	(1.5)
	37.2	15.5	2.6	17.3	32.4	13.1	0.6	12.0	25.0	(2.1)
	31.8	15.1	2.1	16.0	22.8	6.0	(0.8)	11.2	21.8	(4.4)
	26.5	15.1	0.4	15.8	7.4	2.5	(3.8)	7.1	13.7	(8.3)
	19.7	7.8	(12.1)	15.3	(2.0)	(2.2)	(4.5)	2.7	3.5	(13.8)
Lowest	5.9	6.5	(18.4)	4.2	(2.6)	(4.9)	(14.9)	1.0	0.1	(14.6)

For just one example, consider emerging-markets stocks (admittedly a particularly volatile asset class). They were at the top of the chart in 2009 (with a 78% return!) and 2010, only to become the worst performer in 2011, posting an 18% loss. Any asset will likely give you good and bad years; the key is to invest in many, in proportions suited to your return and risk goals.

*Source: Bloomberg, data from 1/1/2009 through 12/31/2018. Diversification does not ensure a profit or guarantee against loss.

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WHAT MATTERS TO YOU MATTERS MOST

Legacies come in all shapes and sizes, many not financial. But if you're interested in leaving funds to your family and/or charities, **get in the habit of preparing to take the necessary steps.**

Here's where the different generations tend to have different priorities. Millennials can feel relatively secure with a portfolio heavily weighted toward stocks, since they can expect very long time horizons—though some may wish to stick their toes into the investment waters with a conservative mix. Many Gen Xers will likely also own stock-tilted portfolios, but probably with more bonds in the balance. Boomers need to be careful, in our view: They may migrate toward bond or even cash portfolios because of stock risk, but with life expectancies for 65-year-olds now well in the 80s, most Boomers shouldn't abandon stocks: They need investment growth as well as safety and income.

Investing Habit #3:
Ask About and Track After-Tax Returns

The tax bite on your investments can be painful—perhaps in the range of 35% or more for investors in high tax brackets living in high-tax states and cities. You can help mitigate the pain by adopting the **habit of being aware of taxes whenever you invest**—certainly in taxable accounts but in retirement accounts as well when you consider which assets you should shelter from taxes. When you're thinking about buying into an investment, ask whether after-tax results are available and what the annual turnover is, since high rates of buying and selling securities mean higher capital-gains taxes.

For Millennials starting out as investors, taxes are often a less-important consideration (unless they're also independently wealthy). As an investor's age increases, all else equal, taxes become more significant. Boomers may think not so at first, since their tax brackets tend to go down after leaving work. But taxes take center stage no later than age 72, when Required Minimum Distributions (RMDs) from most retirement accounts become mandatory (raised from age 70½, courtesy of a late-2019 legislative overhaul).[6] RMDs can be a big deal; investors should consult with their tax professionals.

Want to Leave a Legacy? Plan for It…

Legacies come in all shapes and sizes, many not financial. But if you're interested in leaving funds to your family and/or charities, get in the **habit of preparing to take the necessary steps**. That can mean many things: thinking about who you want to receive the money, how much you wish to give, and when (for example, when you're still living or after your death?); deciding whether you wish to disclose your plans to the recipients or not; and reviewing the possibility of using trusts as a legacy vehicle.

Trusts can be good vehicles for transferring assets to your spouse, your children and grandchildren, charities that are important to you, or both family and charity. In that last instance, you might employ a "charitable lead trust" that gives regular distributions to the charity for a set period of time and leaves the remainder to a

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6. The revised age threshold applies to retirement-account owners who turned 70 1/2 after December 31, 2019. In some cases, employees who are invested in employer-sponsored plans and still working may be able to further postpone taking RMDs; they should consult with their employers and tax advisors.

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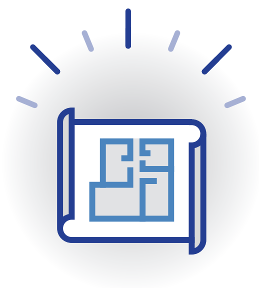

FAILING TO PLAN IS PLANNING TO FAIL

We advise drawing up a blueprint for every financial decision in your life, and then following it through.

family (or any other) beneficiary, or a "charitable remainder trust," which can provide income to family and the remainder to charity. *But don't try to navigate these waters alone:* Work with financial and legal experts in deciding which trust(s), if any, are appropriate for you. And don't forget to ask about the tax consequences and benefits, including for estate tax. Estate taxation affects only the wealthiest right now on the federal level, but that may change. In addition, some states levy their own estate taxes.

Generally speaking, the importance of legacy planning increases with age. For most Millennials it's not on the table. But Gen Xers should think about it, rather than pushing every decision into their retirement years.

…As You Plan for Everything Financial

We advise drawing up a blueprint for every financial decision in your life, and then following it through. That blueprint can be a daily shopping list, an annual spending budget, or a complex estate plan. Indeed, the best plans cover a broad swath of financial territory—always including retirement. Most experts say that you'll need to replace 70-100% of your pre-retirement income after you stop working, which will require a solid (but flexible) plan. Of course, any plan should be re-evaluated and revised frequently, as your circumstances and goals change.

In our view, planning in coordination with financial professionals is appropriate for every age group, with different content. But one feature common to all plans, including those of Millennials, should be specific guidelines for retirement—developed not out of fear but resolution.

The good financial habits in this paper should "die hard," but they're far from an exhaustive list. Want to learn more? We at People's United Advisors can help. Let us know that you're interested.

People's United Advisors can help provide the advice you're seeking.

Please contact us at 1.800.772.8778 or visit peoples.com