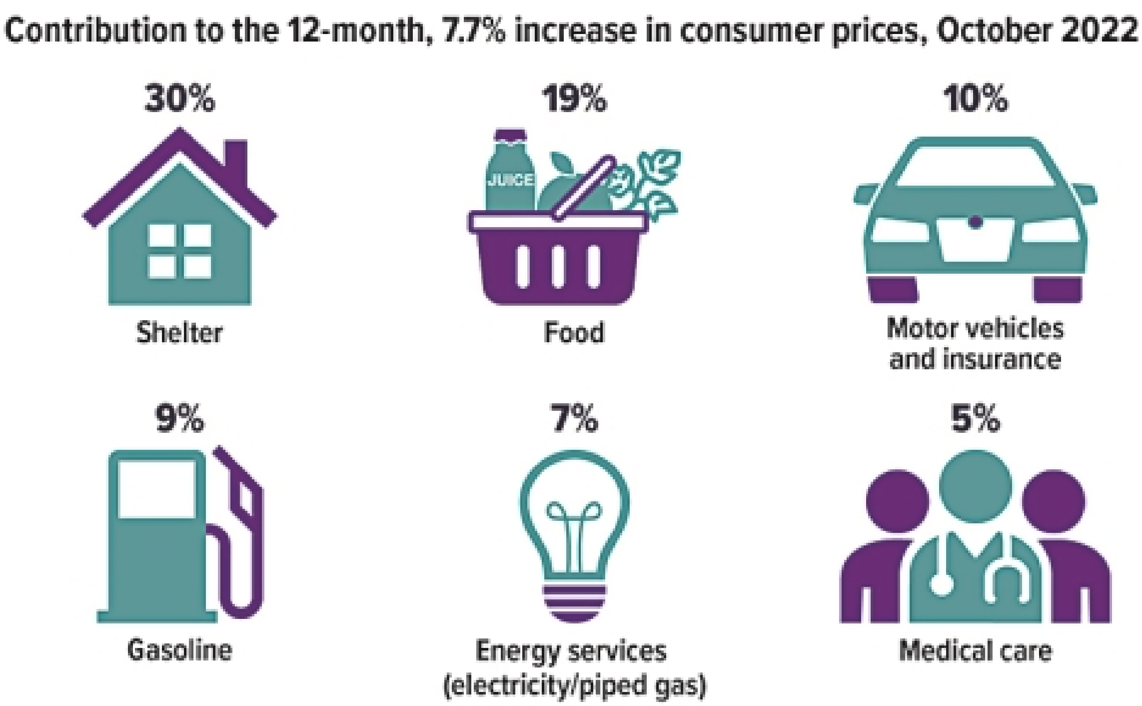
John T. Brennan, Esq. CFP®
SVP, Trust & Financial Services
Cape Ann Savings Bank
Trust & Financial Services
109 Main Street • Gloucester • MA • 01930
978-283-7079
john.brennan@castrust.com • https://www.capeannsavings.bank

The Top Six Inflation Drivers of 2022

In June 2022, the 12-month rise in the Consumer Price Index (CPI) peaked at 9.1%, the fastest pace in 40 years, before dropping to 7.7% in October. This bout of inflation has been driven in large part by steep price hikes for essentials, hitting many U.S. households where it hurts the most. In fact, more than three-fourths of the annual increase in the CPI can be attributed to these six categories.



Source: U.S. Bureau of Labor Statistics, 2022

Debt Optimization Strategies

To help improve your financial situation, you might consider reducing your debt. Before starting any debt payoff strategy (or combination of strategies), be sure you understand the terms of your debts, including interest rates, payment requirements, and any prepayment or other penalties.

Start with Understanding Minimum Payments

You are generally required to make minimum payments on your debt, based on factors set by the lender. Failure to make the minimum payments can result in penalties, higher interest rates, and default. If you make only the minimum payments, it may take a long time to pay off the debt, and you will have to pay more interest over the life of the loan. This is especially true of credit-card debt.

Your credit-card statement will indicate your current monthly minimum payment. To find the factors used in calculating the minimum payment amount each month, you can review terms in your credit-card contract, which can change over time.

The minimum payment for credit cards is usually equal to the greater of a minimum percentage multiplied by the card's balance (plus interest on the balance, in some cases) or a base minimum amount (such as $15). For example, assume you have a credit card with a current balance of $2,000, an interest rate of 18%, a minimum percentage of 2% plus interest, and a base minimum amount of $15. The initial minimum payment required would be $70 [greater of ($2,000 x 2%) + ($2,000 x (18% ÷ 12)) or $15]. If you made only the minimum payments (as recalculated each month), it would take 114 months (almost 10 years) to pay off the debt, and you would pay total interest of $1,314. For consumer loans, the minimum payment is generally the same as the regular monthly payment.

Make Additional Payments

Making payments in addition to your regular or minimum payments can reduce the time it takes to pay off your debt and the total interest paid. Additional payments could be made periodically, such as monthly, quarterly, or annually.

Using the previous example ($70 initial minimum payment), if you made monthly payments of $100 on the credit card debt, it would take only 24 months to pay off the debt, and total interest would be just $396.

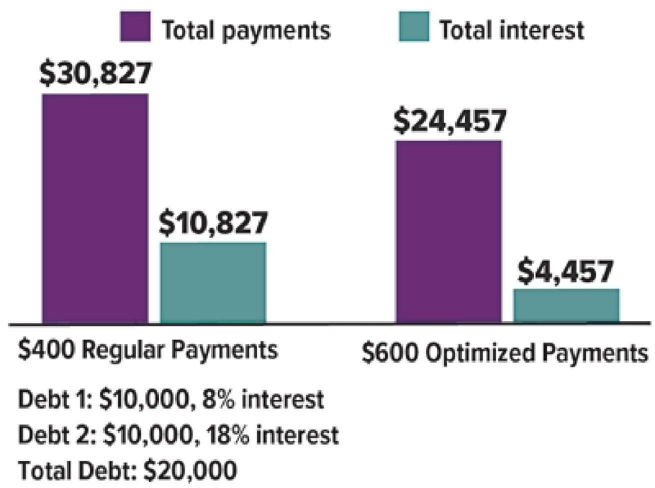
Here's another example. Assume you have a current mortgage balance of $300,000. The interest rate is 5%, the monthly payment is $2,372, and the remaining term is 15 years. If you make regular payments, you will pay total interest of $127,029. However, if you pay an additional $400 each month, it will take only 12 years and one month to pay off the mortgage, and you will pay total interest of just $99,675.

Pay Off Highest Interest-Rate Debt First

One way to potentially optimize payment of your debt is to first make the minimum payments required for each debt and then allocate any remaining dollars to debt with the highest interest rates.

For example, assume you have two debts, you owe $10,000 on each, and each has a monthly payment of $200. The interest rate for one debt is 8%; the interest rate for the other is 18%. If you make regular payments of $400, it will take 94 months until both debts are paid off, and you will pay total interest of $10,827. However, if you make monthly payments of $600, with the extra $200 paying off the debt with an 18% interest rate first, it will take only 41 months to pay off the debts, and total interest will be just $4,457.

Pay Off Highest Interest-Rate Debt First



Use a Debt-Consolidation Loan

If you have multiple debts with high interest rates, it may be possible to pay them off with a debt-consolidation loan. Typically, this will be a home-equity loan with a lower interest rate than the rates on the debts being consolidated. (Note that a federal income tax deduction is not currently allowed for interest on home-equity indebtedness unless it is used to substantially improve your home.) Keep in mind that a home equity-loan potentially puts your home at risk because it serves as collateral, and the lender could foreclose if you fail to repay. There also may be closing costs and other charges associated with the loan.

All examples are hypothetical and used for illustrative purposes only and do not represent any specific investments or products. Fixed interest rates and payment terms are shown, but actual interest rates and payment terms may change over time. Actual results will vary.

Three Stretch IRA Alternatives

The passage of the SECURE Act in 2019 effectively eliminated the stretch IRA, an estate planning strategy that allowed an inherited IRA to continue growing tax deferred, potentially for decades. Most nonspouse beneficiaries, including children and grandchildren, can no longer stretch distributions over their lifetimes. Moreover, proposed IRS regulations require most designated beneficiaries to take annual required minimum distributions (RMDs) within the 10-year distribution period if the original account owner died on or after his or her required beginning date. This shorter distribution period could result in unanticipated and potentially large tax bills for nonspouse beneficiaries who inherit high-value IRAs.

You may be looking for alternative ways to preserve your wealth and pass it on to your beneficiaries. Here are three options you might consider.

Roth Conversion

If you are willing to pay income taxes now instead of your beneficiaries paying them later, you could convert your IRA to a Roth IRA. Anyone can convert a traditional IRA to a Roth IRA. However, you generally have to include the amount you convert in your gross income for the year converted. Not only would you have to pay taxes on the amount converted, but the beneficiaries of your Roth IRA will generally have to liquidate the account within 10 years of inheriting it, although they won't pay federal income taxes on the distribution(s).

Life Insurance

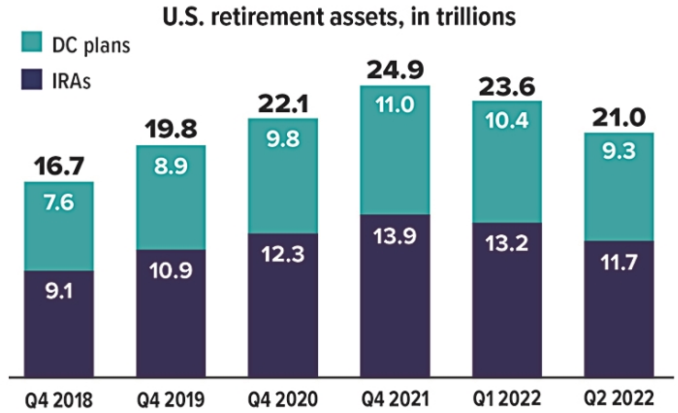
You could take distributions from your IRA and use them to buy life insurance on your life. The beneficiaries you name in the life insurance policy will receive those proceeds tax-free at your death. The policy beneficiaries could use the tax-free proceeds of the life insurance to pay any income taxes they would owe on the balance of the IRA they inherit from you. Or, if you've been able to liquidate or spend down your IRA during your lifetime, the tax-free life insurance death benefit would replace some or all of the taxable IRA that otherwise would have been inherited by the beneficiaries.

Irrevocable Trust

You could create an irrevocable trust and fund it with non-IRA assets. An irrevocable trust can't be changed or dissolved once it has been created. You generally can't remove assets, change beneficiaries, or rewrite any of the terms of the trust. Often, life insurance is used to fund the irrevocable trust. You can direct how and when the trust beneficiaries are to receive the life insurance proceeds from the trust after your death. In addition, if you have given up control of the property, all of the property in the trust, plus any future appreciation on the property, is removed from your taxable estate.

Wealth Cache

Assets held in individual retirement accounts (IRAs) and defined-contribution plans such as 401(k)s dipped in the first half of 2022 to $21 trillion. Even so, that total was up more than 25% from year-end 2018.



Source: Investment Company Institute, 2022

While trusts offer numerous advantages, they incur upfront costs and often have ongoing administrative fees. The use of trusts involves a complex web of tax rules and regulations. You should consider the counsel of an experienced estate planning professional and your legal and tax professionals before implementing such strategies.

As with most financial decisions, there are expenses associated with the purchase of life insurance. Policies commonly have mortality and expense charges. The cost and availability of life insurance depend on factors such as age, health, and the type and amount of insurance purchased. In addition, if a policy is surrendered prematurely there may be surrender charges and income tax implications. Any guarantees are subject to the financial strength and claims-paying ability of the insurer.

To qualify for the tax-free and penalty-free withdrawal of earnings, a Roth IRA must meet the five-year holding requirement, and the distribution must take place after age 59½ or due to the owner's death, disability, or a first-time home purchase ($10,000 lifetime maximum). Under current tax law, if all conditions are met, the Roth IRA will incur no further income tax liability for the rest of the owner's lifetime or for the lifetimes of the owner's heirs, regardless of how much growth the account experiences.

Three Ways to Help Simplify Your Finances

Over time, finances tend to get complicated, especially when you're juggling multiple goals and accounts. Simplifying your finances requires a bit of effort up front, but making just a few changes may help free up more time to focus on your financial priorities.

Make Saving Automatic

Saving for a goal is simpler when money is set aside automatically. For example, you may be able to regularly and automatically deposit a portion of your paycheck into a retirement account through your employer. Your contribution level may also increase automatically each year, if your plan offers this feature. Employers may also allow you to split your direct deposit into multiple accounts, enabling you to build up a college fund or an emergency fund, or direct money to an investment account.

Another way to make saving for multiple goals easier is to set up recurring transfers between your savings, checking, or other financial accounts. You decide on the frequency and timing of those transfers, and you can quickly make necessary adjustments.

Consolidate Retirement Funds

If you've had a few jobs, you might have several retirement accounts, such as IRAs and 401(k) or 403(b) plans, with current and past employers. Consolidating them in one place may help make it easier to monitor and manage your retirement savings and distributions, and prevent you (or your beneficiaries) from forgetting about older or lower-balance accounts. Not all accounts can be combined, and there may be tax consequences, so discuss your options with your financial and/or tax professionals.

Take a Credit Card Inventory

Credit cards are convenient, but managing multiple credit-card accounts can be time-consuming and costly. Losing track of balances and due dates may lead to increased interest charges or late payments. You could also miss out on some of the rewards and benefits your cards offer. If you've accumulated a few credit cards, review interest rates, terms, credit limits, and benefits that may have changed since you got the cards. Ordering a copy of your credit report can help you quickly see all of your open credit-card accounts — there may be some you've forgotten about. Visit annualcreditreport.com to get a free credit report from each of the three major credit reporting agencies (Experian, Equifax, and TransUnion).

Once you know what you have, you can decide which cards to use and put the rest aside. Because it's possible that your credit score might take a temporary hit, it may not always be a good idea to close accounts you're not using unless you have a compelling reason, such as a high annual fee or exposure to fraud.