INVESTMENT INSIGHTS

Analysis, Insights, and a Different Perspective April 2023

KEY POINTS

- In this issue, we examine three possible ways to effectively utilize tax refunds to work toward different goals: financial freedom from debt, financial preparation for unexpected circumstances, and financial confidence for retirement.
- While we provide general guidelines, each individual's priorities will differ depending on their specific financial circumstances.
- It is crucial to have a financial plan tailored to your individual needs.

UNLOCKING YOUR TAX REFUND'S POTENTIAL IN 2023

Last year, more than 165 million people filed their taxes and received more than $359 billion in tax refunds.[1] The average return was $3,252, up nearly 15% from the year before. A large tax refund can provide an opportunity to improve financial well-being. This issue of Investment Insights discusses three of the many possibilities to effectively utilize a tax refund.

FINANCIAL FREEDOM

For people with high-interest credit card debt, reducing or potentially eliminating debt can be one of the best uses of their tax refund because credit card debt is often more expensive than other types of debt. In 2022, the average credit card interest rate was 20.40%.[2] By reducing or eliminating this debt, credit card holders pay less in future finance charges.

Traditionally, consumer credit debt has increased year over year. Between 2011 and 2019, the average credit card debt increased from $5,175 to $6,194, representing an almost 20% increase. Then in 2020, for the first time in a decade, the average credit card debt dropped to $5,897 and to $5,525 in 2021. The likely reason for this trend is that many individuals used their economic stimulus payments to pay down their credit card debt.

As the economy normalizes post-Covid and inflation has grown, credit card debt has increased again to an average of $5,910 in

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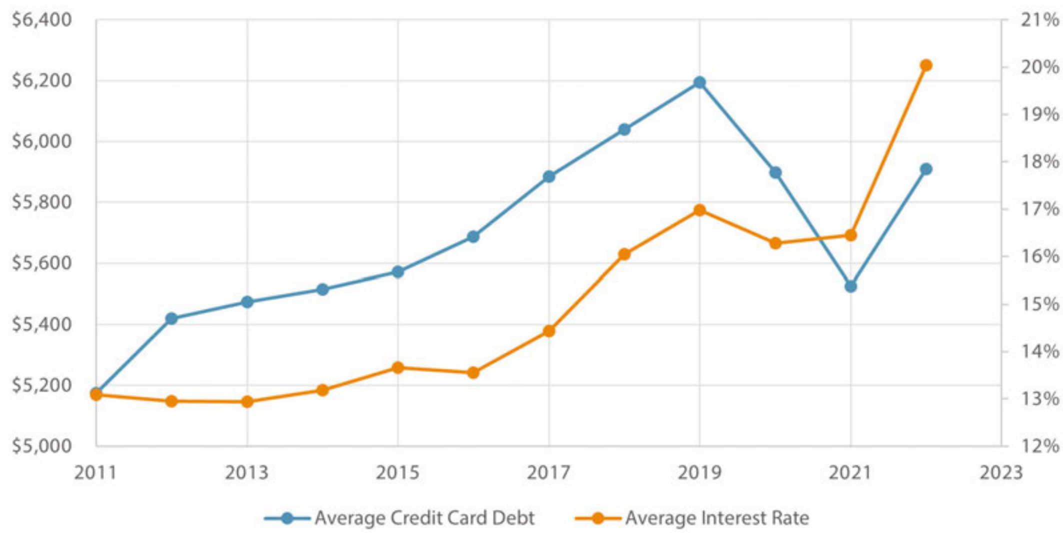
1 Internal Revenue Service, December 30, 2022.
2 The Board of Governors of the Federal Reserve System, G-19 Report.

2022, representing approximately a 7% jump compared to the prior year. The average credit card interest rate also increased by about four percentage points from 16.45% to 20.40% last year. A person with credit card debt of $5,910 with an interest rate of 20.40% is expected to pay about $1,200 in interest payments.[3] If they used their entire tax refund of $3,252 to reduce their credit card debt, they could save more than $660 in interest payments.[4] For people with credit card debt, a smart use of a tax refund may be to reduce or eliminate high-interest debt obligations.

CREDIT DEBT AND INTEREST RATE RISE AGAIN



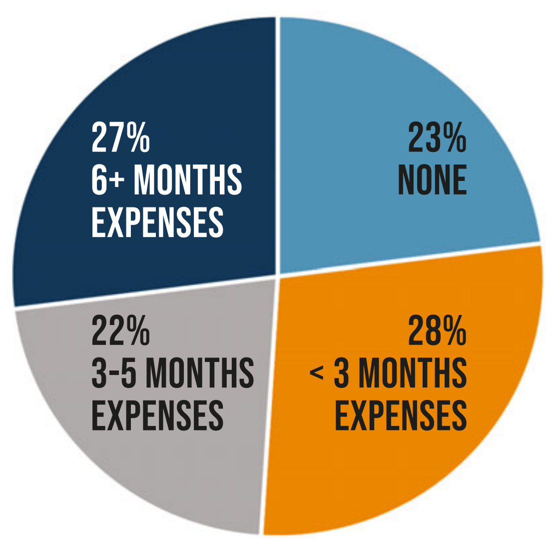
Source: The Board of Governors of the Federal Reserve System, G-19 Report and Experian.

FINANCIAL PREPARATION

Another potential use of a tax refund is to create an emergency fund. Whether to use a tax refund for paying high-interest debt depends on the individual and their specific situation, but creating an emergency fund should be one priority for those with no money set aside for unexpected incidents. An emergency fund typically consists of cash savings that provide people with financial stability in case of unanticipated situations, such as losing a job, experiencing a medical emergency, car repairs, etc. In such situations, people lacking savings may find themselves with no choice but to accrue more debt, pushing them further from financial independence.

Most Americans do not have enough saved for an unexpected financial emergency. As shown in the graph to the right, a survey by Bankrate found that about half of Americans do not have enough savings to cover expenses for three months. Additionally, about 1 in 4 responded that they have no emergency savings. In a study published in 2017, the Pew Charitable Trusts found that 56% of households experienced at least one financial shock per year.[5] The Pew defined

HOW MUCH MONEY DO AMERICANS HAVE IN EMERGENCY SAVINGS?



3 20.40% of $5,910 is $1,205.64.
4 20.40% of $2,658 ($5,910 minus $3,252) is $542.23 which is $663.41 less than $1205.64.
5 The Pew Charitable Trusts, Financial Shocks Put Retirement Security at Risk, October 25, 2017.

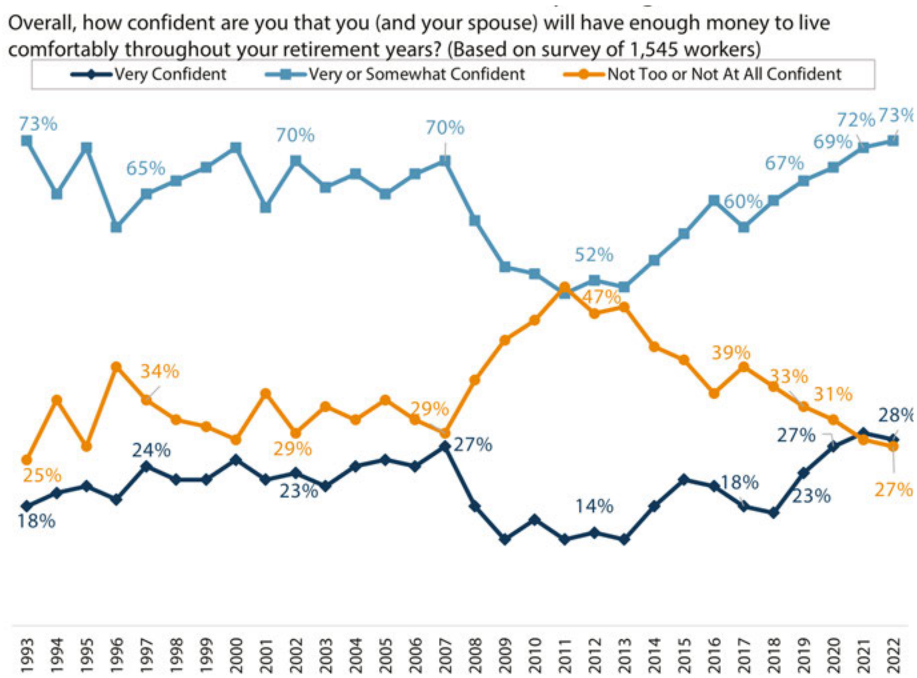
financial shock as "large unplanned expenses, such as a major home or car repair, or income lost due to unemployment, a pay cut, illness, injury, or death." The study found that the median cost of a financial shock was $2,000. One-quarter of respondents, however, faced an expense of $6,000 or more. A more recent study by the Federal Reserve found that 20% of adults had an unexpected medical expense, and a natural disaster directly impacted 16% of adults in the past 12 months.[6]

To help soften the blow of a financial shock, consider tucking a portion of your tax refund into savings in the event of unexpected needs. If you have an existing emergency fund, consider adding to it. It is generally recommended to have savings equal to three to six months of living expenses, depending on the stability of your income and financial obligations.

FINANCIAL CONFIDENCE

Individuals with an existing emergency fund and minimal high-interest debt may find it beneficial to allocate their tax refund toward retirement savings. Many investors often regret waiting too long and not initiating retirement savings earlier. In fact, if given the opportunity to start over, nearly 70% of retirees would have started saving much earlier.[7] These individuals may be among the 23% of Americans who do not feel very confident about their ability to have enough money to live comfortably throughout their retirement years.[8]

WORKER CONFIDENCE IN FINANCIAL SECURITY THROUGH RETIREMENT



Source: Employee Benefit Research Institute and Greenwald & Associates, 1993-2022 Retirement Confidence Surveys.

Most Americans start saving for retirement later in life. A survey last year found that 55% of them were behind on retirement savings.[9] Not everyone treats this time as a precious resource. It is an important reminder that time is an asset that diminishes in value each day when your money is not given the opportunity to work. As the value of time is squandered, the cost of your financial goals increases, sometimes to the point of becoming prohibitively expensive and unachievable. Thus, consider enhancing your existing savings or starting your retirement savings journey with this year's tax refund.

6 Economic Well-Being of U.S. Households in 2021 by The Federal Reserve.

7 Bearden, Bridget. "Retiree Reflections." EBRI.

8 Employee Benefit Research Institute and Greenwald Research, 2022 Retirement Confidence Survey.

9 Royal, James. "Survey: 55% of Working Americans Say They're behind on Retirement Savings." Bankrate.

FINANCIAL PLAN

Ultimately, a tailored financial plan is the most crucial aspect of financial well-being. A recent study revealed that 83% of Americans express at least some confidence in reaching their financial goals when they have a written plan, compared with a mere 40% for those without a written plan.[10] Despite its benefits, only about 28% of Americans have a written financial plan.[11]

Whether you use your tax refund to reduce debt, increase your emergency fund, or save for retirement depends on your specific situation; your financial plan depends on your financial needs. Contact your financial advisor today if you need to create a financial plan or have questions about your current plan.

10 Employee Benefit Research Institute and Greenwald Research, 2022 Retirement Confidence Survey.
11 M, Yaqub. "What Percentage of Americans Have a Financial Plan in 2022." BusinessDIT, October 23, 2022.