

Investor's Edge

Second Quarter 2018

Strategic debt practices create a new paradigm for building and preserving wealth

How do you feel about borrowing money. Does the idea of having debt make you uncomfortable? Given a choice and the resources to do so, would you eliminate all your debt today?

If you are like most Americans, you may have a mostly negative point of view about debt. However, for financially successful individuals or families, there may actually be intelligent, practical ways that strategic debt can help build and preserve wealth.

This may sound unbelievable. So it may help to clarify an important point: strategic debt is not intended to be used to buy things you cannot afford. Instead, it may offer potential advantages to enable purchases you can afford – in a manner that makes strategic sense regarding your overall circumstances and wealth management goals.

Before introducing some key ideas regarding strategic debt practices, it may help to quickly address three concepts that may help transform your attitudes about borrowing money. With a renewed outlook, you may be ready to make informed, rational choices regarding strategic use of debt.

Adopt a holistic approach to your personal balance sheet

As an investor, building and preserving wealth may be top priorities. Yet

focusing on just one half of your personal balance sheet – the assets half – means that you may not be thinking about how the liabilities side may contribute to your overall net worth and, therefore, your overall resources. Adopting a holistic approach to managing wealth by concentrating on making the most effective use of both sides of your balance sheet may help improve your outcomes.

You need to ask yourself, “Am I managing toward – and taking full advantage of – my complete financial picture, including liabilities?”

Think like a company

Virtually all companies embrace debt. In fact, there are only two remaining AAA-rated companies in the United States. While many companies could potentially be AAA rated, they proactively choose to take on debt, which results in a lower credit rating (among other factors). Do they do this because they cannot afford to pay off their debt? No. They use credit because they realize that correctly structured debt actually makes them stronger, longer lasting and more profitable.



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Another fact to consider is that all corporate debt is issued as an interest-only loan – not some of it, not 99 percent of it, but all of it. When you buy a bond, you receive regular interest payments with return of principal at the end of the term. You need to ask yourself, “How do the companies in my stock-and-bond portfolio deploy credit strategically?”

Challenge common wisdom

Debt has a terrible reputation, which is why most of us work so hard to become debt free. But please understand that your rate of return on paying off debt is exactly equal to the after-tax cost of that debt.

For example, if you have a \$100,000 loan at 4.5 percent interest and you receive a sudden windfall and have the means to pay it all off, you will save \$4,500 a year in interest, or a 4.5 percent rate of return. You need to ask yourself, “Compared with paying off loan principal, are there investments I could allocate my money toward that may earn a greater rate of return than my interest payment?”

Do the one thing all companies do

While nearly all publicly traded companies in America choose to use debt strategically, the fact is that it may not be right for every individual. However, all companies do proactively choose to have access to liquidity in the event of an emergency.

When companies establish lines of credit, they again take a holistic approach to their balance sheet, factoring in all circumstances, and look for the lowest rates and most flexible terms possible. Individuals can do the same thing, typically through an asset-



based loan facility. This may include setting up a line of credit or opening a margin account where you pledge eligible securities as loan collateral. The amount of credit available may be up to a certain percentage of the value of the assets pledged. Generally speaking, the greater the value of assets pledged, the more favorable the interest rate charged.

Explore a practical solution for many goals

An asset-based loan facility is one loan that can serve many purposes. In addition to helping you “self-insure” against risk in general (without having to underwrite an insurance policy or pay insurance premiums), it has the potential to help you:

- seize timely investment opportunities
- increase return potential and/or make money on the money you borrow
- finance expensive items/assets (such as real estate) for competitive rates
- gain negotiating power on major purchases by offering “cash in hand”
- consolidate higher-interest debt at a more favorable rate
- diversify concentrated stock positions
- invest in businesses or securities to create income
- manage tax liabilities or create tax-advantaged income

It may sound counterintuitive, but you can even use strategic debt to decrease your overall risk exposure. And you can

accomplish all of these goals without selling securities in your portfolio. This may allow you to continue working toward your long-term investment strategy.

A few words of caution

Like all investing decisions, there are risks associated with strategic debt practices. For example, the loan provider will require that the value of the assets stay above a certain level. Should the asset value fall beneath the stated level, the lender may require that additional assets or money be deposited. Otherwise, the lender may have the authority to sell pledged assets at its discretion to satisfy some or all of the loan amount. For these and other reasons, this form of borrowing may not be suitable for everyone.

Now may be the time to consider how having the right amount of the proper kind of debt might help expand your opportunities and enhance your financial well-being. To learn more about the strategic use of debt – and for help determining if it is appropriate for your goals and circumstances – please contact your financial advisor.

Ideas in this article are based on “The Value of Debt” by New York Times and USA Today best-selling author Thomas J. Anderson. He is the Founder and CEO of Supernova Companies, LLC.

Asset-based lending may not be suitable for all investors. You must maintain sufficient collateral to support outstanding loans. Before using such products, you should read the Margin Disclosure Statement or line of credit literature and regulatory disclosures to ensure you understand the risks involved.

Lending services are offered to our firm’s clients by different entities. Our firm and/or your financial advisor may receive compensation in conjunction with offering or referring these services.

Our firm does not provide tax or legal advice. All decisions regarding the tax or legal implications of your investments should be made in connection with your independent tax or legal advisor.

Teach children how to manage money responsibly

Every April, educators and financial services professionals celebrate Financial Literacy for Youth Month by hosting activities and providing information to help children develop healthy money habits. As a financial role model, there are practical things you can do year-round to help the young people you care about learn how to manage money responsibly – both for today and for tomorrow.

For younger children (up to age 10)

All children, and especially younger ones, learn from seeing and doing. When they are learning about numbers, start teaching them about money by talking about the values of coins and small bills. Then let them use real money to make “pretend” purchases of household items, including learning to make proper change.

Make sure you model good spending habits. When you shop, explain that everything costs money, how to compare prices and how to buy items on sale. Discuss the importance of planning by preparing a list ahead of time and using it to avoid impulse purchases.

For older children (ages 11-15)

Once they are old enough to earn money by helping around the house, babysitting and doing chores for neighbors, help them explore the four pillars of finance.

Spending – Have them allocate some of their earnings to a short-term cash fund they can use to spend as they choose, such as purchasing music, movies or games they want.

Saving – Also have them allocate money toward longer-term goals. Perhaps they want to save for a smartphone, a bicycle or a trip with a youth organization to which they belong. The purpose is to help them learn the satisfaction of saving for a goal and ultimately achieving it.

Giving – Many families impress upon children the importance of sharing what they have with others. Encourage



them to donate part of their money to a charitable, religious or educational group that is important to your family.

Investing – Play an informal stock market game by tracking performance of several stocks of companies they can relate to through the products they use. Explain that investing offers both risks and rewards – and that successful investors often hold stocks for the long term.

For young adults (ages 16-21)

Young adults may be saving toward more expensive goals. Perhaps they want to purchase their first car or help contribute to their college education. If this is the case, consider matching a certain portion of their savings as an incentive.

This may also be the time to open a custodial account to make small investment transactions on behalf of

young adults who have the proper maturity and financial resources. When they become legal adults, the custodial account is then transferred to them to manage, after which you may want to offer to help them make decisions before they buy or sell securities. In terms of investing for education goals, custodial accounts are considered assets of the student for financial aid purposes.

As a financially responsible adult, there is much you can do to help provide a good foundation in money management and investing for the children you care about – and those are skills that can last a lifetime.

For more information about helping children develop financial literacy skills, please call your financial advisor.

Responsible investing principles support goals-based planning

April 22 is traditionally set aside to honor Earth Day. First formally recognized 48 years ago, it has evolved into an international celebration, with nearly 200 countries holding events to support clean air, clean water and other measures to protect our planet.

Today, many individuals are upholding the ideals behind Earth Day – every day – by making financial choices to reflect their environmental values. And by using responsible investing principles to select the securities you own, you can likewise incorporate your values into your goals-based approach to wealth management.

Used in a manner similar to an alternative investment, you can allocate a portion of your portfolio to responsible investments for diversification purposes. Or you may allocate as much as you wish to responsible investments without sacrificing your ability to work toward your financial goals. The choice is yours.

To get started, talk with your financial advisor. You may want to determine what issues you care about. For example, if you are concerned about the environment, you might say global warming, pollution and sustainability are all issues that matter to you.

As a next step, you may want to prioritize which issue is most urgent for you. You might then pick one issue in particular, such as global warming, and focus your responsible investment efforts upon addressing it specifically.

Alternatively, you may want to look for opportunities to combine your interests and pick a sector of the economy with

consequences for all three hypothetical issues. In this scenario, you might choose to direct your responsible investing efforts toward the fossil fuel industry.

After prioritizing the issues, you may then want to determine which responsible investing strategy to adopt. Generally there are three widely accepted choices:

Socially responsible investing – This strategy uses a set of parameters you define to remove or avoid investments you may object to based on your values. Using the fossil fuel industry example, it is for when you want to say, “None of this for me,” simply by not participating in the financial success of oil producers.

Environmental, social and governance – This strategy allows you to select money managers who seek investments that perform well financially in addition to performing well on these desirable metrics. Using the fossil fuel industry example, it is for when you want to say, “I want to be a positive influence on this,” perhaps by choosing managers who include environmental stewardship when evaluating securities.

Impact investing – This strategy focuses on putting money to work to solve a specific problem as a primary goal, with financial return being a secondary,

though equally necessary, goal. Using the fossil fuel industry example, it is for when you want to say, “I want to change this,” perhaps by helping capitalize oil producers making strong progress toward renewable energy sources.

To be clear, responsible investing is not philanthropy. In fact, Oxford researchers analyzed nearly 200 published academic research papers in 2014 and reported that 80 percent of studies show stock price performance to be positively influenced by good sustainability practices.*

So, adopting responsible investing best practices can be empowering, both financially and in terms of your values. After all, you are connecting three of the things that may be most important to you: your deeply held personal beliefs, your financial goals, and the wealth you have worked hard and invested carefully to earn. Consider exploring this opportunity in 2018.

To learn more about responsible investing and goals-based wealth management, please contact your financial advisor.

*Clark, Gordon, Andreas Feiner, and Michael Viehs. 2014. “How Sustainability Can Drive Financial Outperformance.”



Aging and finances: What everyone needs to know

No matter how you envision spending your retirement years, a common goal shared by many may be simply enjoying the ability to age gracefully, maintaining a sense of independence, dignity and well-being throughout a long and happy life. While paying attention to declining physical abilities is essential to achieving this goal, it is equally important to watch for declining mental abilities.

The reason is that a serious decline in memory and/or mental acuity, such as the onset of dementia or Alzheimer's disease, can affect financial decision-making ability. This may leave individuals vulnerable to accidentally mismanaging their money or falling victim to fraud schemes that prey on the elderly or mentally infirm.

Age is the primary risk for developing dementia. And this risk increases as one ages. Given these two facts, along with the aging population, it may be likely that nearly every American family will be impacted by dementia or Alzheimer's. Not everyone will experience its debilitating effects personally; however, most people alive today will likely be part of a dementia caregiver chain at some point in time.

This is why it is important to understand the warning signs, whether in your own behavior or in the behavior of your loved ones. Some of the earliest signs of dementia can be seen in a change in how people handle their finances. Difficulty with bill paying, record keeping and account monitoring tasks, as well as difficulty remembering computer passwords or understanding basic financial concepts, are all concerns to watch for.

With early detection, the chance of costly financial mistakes or abuse can be mitigated and managed. Planning steps taken in advance of a dementia diagnosis can also help make the management process easier. This may be especially important for women, who live longer than men on average and may therefore be exposed to a greater possibility of suffering a decline in mental ability in addition to a greater potential cost of care for it.

As you age – or when you see someone you care about show early signs of capacity decline – one preventive step includes asking a trusted family member or close friend to review financial statements and transactions on a regular basis. It also includes providing your financial institutions with a trusted contact, which will help facilitate prompt discussions when there is suspected fraud or a decline in judgment.

Should dementia be diagnosed, swift action must be taken to help manage its implications. From a financial perspective, that means protecting against potential fraud, money mismanagement or even personal liability. The good news is that the securities industry now requires advisors to ask all clients for a trusted-contact number, which is designed to



help protect the growing number of the vulnerable as the population ages.

By being aware of potential financial risks resulting from mental incapacity, knowing when it may be time to seek help, and making it clear whom we may contact on your behalf should we have reasonable concerns, you may feel more confident that appropriate measures are in place to help safeguard your financial security.

For more information, please contact your financial advisor.



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