



DaVinci Financial Designs

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Hello!

We are excited to present our first DaVinci Financial Designs Newsletter. If you have any questions about what you have read, please call us. We look forward to continuing to assist you in reaching your financial dreams.

Jim, Carolyn, Jessica, Brad,
Jeanine, Stan and Ashley

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Market-Moving Indicators for Monitoring Europe

If you've struggled to make sense of the ongoing European debt debacle, you're not alone. It's difficult even to keep track of all the pieces of this financial Rube Goldberg puzzle, let alone understand how they can influence one another.

Though new aspects of the situation seem to crop up every month, here are some of the most common factors that either reflect or affect sentiment about what's happening in Europe. Knowing about them might help you understand why markets react to a seemingly obscure headline. After all, one of the few things that almost everyone seems to agree on is that the situation isn't likely to be solved overnight.

Take an interest in interest rates

Interest rates on sovereign debt are perhaps the most closely watched indicator. When demand for a country's bonds is low because investors are concerned about the possibility that they might not be repaid in full and on time, that country must offer a higher interest rate in order to borrow money to finance its day-to-day operations.

Interest rates become particularly worrisome when they reach or exceed 7%. That's the level that prompted Greece, Ireland, and Portugal to seek bailouts from their European peers, and it's widely seen as unsustainable. When a country must pay that much simply to service its debt, investors become concerned that high borrowing costs will make a country's financial situation even worse.

Watch credit ratings

Troubled European countries are struggling to deal with a devilish Catch-22. In many cases, unsustainable debt burdens have led to stringent austerity measures; however, such measures also can hamper economic growth, which reduces tax revenue and can potentially increase deficits. Higher deficits can lead to a lower credit rating that in turn can mean higher borrowing costs, bringing on the problems discussed above and potentially launching a new downward economic cycle. Thus, a downgrade to a country's credit rating tends to raise concerns.

However, investor reaction also can be unpredictable. For example, Standard & Poor's January downgrade of nine sovereign nations and the European Financial Stability Fund was largely met with a shrug by investors. There's been so much pessimism about Europe for so long that in some cases, markets may already have priced in much of the bad news.

Monitor credit default swap costs

A credit default swap (CDS) is a form of insurance against the possibility that a bond issuer might default or fail to make a payment on its obligations. Bondholders buy a CDS from a financial institution or insurance company that promises to reimburse the bondholder for any losses sustained in the event of a default. The cost of that insurance is seen as a proxy for the perceived risk involved in investing in a particular country's bonds. The higher the cost of a CDS on, say, Italian sovereign debt, the greater the anxiety about whether the bond issuer will default and the CDS issuer will have to pay.

Follow the money

To prevent credit markets from seizing up, the European Central Bank late last year provided almost €500 billion in three-year loans to European banks, making it easier for them to refinance their debt. The level of borrowing at the ECB is seen as one indicator of how banks are being affected by their holdings of sovereign debt. The greater the need to borrow from the ECB, the greater the banks' perceived level of vulnerability.

Bailouts: Nein nein nein?

U.S. voters aren't the only ones who are sensitive about bailouts; so are Germans. As Europe's most powerful economy and the one with the best credit rating, Germany is the tentpole upon which European financial stability hangs. However, by the end of 2011, the German economy had begun to slow. Any indications that economic pressure could threaten Germany's ability and willingness to remain strong in its support of the eurozone can spook anxious investors.



Ways Parents Can Help Their Boomerang Kids



A financial strain

Parents naturally want to help their children during hard times, but in some cases, the financial strain of another adult (or two or three) in the house can be too much of a financial shock. If your adult child needs to move back home, discuss how long your child plans to stay and how he or she can contribute financially to the household.



It's been called the new retirement wild card. But it's not inflation, health-care costs, or taxes, though those things certainly matter. What is it that's causing so much uncertainty? It's boomerang kids, and the money their parents spend on them.

The trend

According to the U.S. Census Bureau, there were 6 million young adults ages 25 to 34 living at home in 2011--19% of all men (up from 14% in 2005) and 10% of all women (up from 8% in 2005). Not surprisingly, the percentages are higher for young adults in the 18 to 24 age bracket, with 59% of young men and 50% of young women living with their parents in 2011.

Sociologists have cited a number of reasons for this trend--the recession, college debt, the high cost of housing, delayed marriage, and a tendency toward prolonged adolescence. But whatever the reason, there's no doubt that boomerang children can be a mixed blessing for their parents, both emotionally and financially. Just when parents may be looking forward to being on their own and preparing for their retirement, their children are back in the nest and relying on their income. While the extra company might be welcome, you don't want to sacrifice your emotional and financial health to help your kids.

Set ground rules

If your adult children can't afford to live on their own, establish ground rules for moving back home, including general house rules, how long they plan to (or can) stay, and how they can contribute to the household in terms of rent and chores. As an adult, your child should be expected to contribute financially to the household overhead if he or she is working. Determine a reasonable amount your child can contribute toward rent, food, utilities, and car expenses. You can then choose to apply this money directly to household expenses or set it aside and give it to your child when he or she moves out, when it can be used for a security deposit on an apartment, a down payment on a car, or some other necessary expense.

You should also discuss your child's long-term plan for independence. Does your child have a job or is he or she making sincere efforts to look for work? Does your child need or want to go back to school? Is your child working and saving money for rent, a down payment on a home, or graduate school? Make sure your child's plans are realistic and that he or she is taking steps to meet those goals.

It's a balancing act, and there isn't a road map or any right answers. It's common for parents to

wonder if they're making a mistake by cushioning their child's transition to adulthood too long or feel anxious if their child isn't making sufficient progress toward independence.

Turn off the free-flowing money spigot

It can be tempting for parents to pay all of their adult children's expenses--big and small--in an effort to help them get on their feet, but doing so is unlikely to teach them self-sufficiency. Instead, it will probably make them further dependent on you.

If you can afford it, consider giving your child a lump sum for him or her to budget rather than just paying your child's ongoing expenses or paying off his or her debt, and make it clear that is all the financial assistance you plan to provide. Or, instead of giving your child money outright, consider loaning your child money at a low interest rate. If you can't afford to hand over a sum of cash or prefer not to, consider helping with a few critical expenses.

Evaluate what your money is being spent on. A car payment? Credit card debt? Health insurance? A fancy cell phone? Student loans? General spending money? Your child is going to have to cut the frills and live with the basics. If your child is under age 26, consider adding him or her to your family health plan; otherwise, consider helping him or her pay for health insurance. Think twice about co-signing a new car loan or agreeing to expensive lease payments. Have your child buy a cheaper used car and raise the deductible on his or her car insurance policy to lower premiums. Help your child research the best repayment plan for student loans, but don't pay the bills unless absolutely necessary. Same goes for credit card balances. Have your child choose a less expensive cell phone plan, or consolidate phones under a family plan and have your child pay his or her share. Bottom line--it's important for your child to live within his or her financial means, not yours.

Solidify your own retirement plan

Even if your child contributes financially to the household, you may still find yourself paying for items he or she can't afford, like student loans or medical bills, or agreeing to pay for bigger ticket items like graduate school or a house down payment. But beware of jeopardizing your retirement to do this--make sure your retirement savings are on track. A financial professional can help you see whether your current rate of savings will provide you with enough income during retirement, and can also help you determine how much you can afford to spend on your adult child now.

Pay Down Debt or Save and Invest?



Should you pay off debt or should you save and invest? To find out, compare what rate of return you can earn on your investments versus the interest rate on the debt. There may be other factors that you should consider as well.

There are certainly a variety of strategies for paying off debt, many of which can reduce how long it will take to pay off the debt and the total interest paid. But should you pay off the debt? Or should you save and invest? To find out, compare what rate of return you can earn on your investments versus the interest rate on the debt. There may be other factors that you should consider as well.

Rate of return on investments versus interest rate on debt

Probably the most common factor used to decide whether to pay off debt or to make investments is to consider whether you could earn a higher after-tax rate of return on the investments than the after-tax interest rate on the debt if you were to invest your money instead of using it to pay off the debt.

For example, say you have a credit card with a \$10,000 balance on which you pay nondeductible interest of 18%. You would generally need to earn an after-tax rate of return greater than 18% to consider making an investment rather than paying off the debt. So, if you have \$10,000 available to invest or pay off debt and the outlook for earning an after-tax rate of return greater than 18% isn't good, it may be better to pay off the debt than to make an investment.

On the other hand, say you have a mortgage with a \$10,000 balance on which you pay deductible interest of 6%. If your income tax rate is 28%, your after-tax cost for the mortgage is only 4.32% ($6\% \times (1 - 28\%)$). You would generally need to earn an after-tax rate of return greater than 4.32% to consider making an investment rather than paying off the debt. So, if you have \$10,000 available to invest or pay off debt and the outlook for earning an after-tax rate of return greater than 4.32% is good, it may be better to invest the \$10,000 rather than using it to pay off the debt.

Of course, it isn't an all-or-nothing choice. It may be useful to apply a strategy of paying off debts with high interest rates first, and then investing when you have a good opportunity to make investments that may earn a higher after-tax rate of return than the after-tax interest rate on the debts remaining.

Say, for example, you have a credit card with a \$10,000 balance on which you pay 18% nondeductible interest. You also have a mortgage with a \$10,000 balance on which you

pay deductible interest of 6%, and your tax rate is 28%. So, if you have \$20,000 available to invest or pay off debt, it may make sense to pay off the credit card with \$10,000 and invest the remaining \$10,000.

When investing, keep in mind that, in general, the higher the rate of return, the greater the risk, which can include the loss of principal. If you make investments rather than pay off debt and your investments incur losses, you may still have debts to pay, but will you have the money needed to pay them?

Some other considerations

When deciding whether to pay down debt or to save and invest, you might also consider the following.

- What are the terms of your debt? Are there any penalties for prepayment?
- Do you actually have money that you could invest? Most debts have minimum payments that must be paid each month. Failure to make the minimum payment can result in penalties, increased interest rates, and default. Are your funds needed to make those payments?
- How much debt do you have? Is it a problem? How do you feel about debt? Is it something you can easily live with or does it make you uncomfortable?
- If you say you will save the money, will you really invest it or will you spend it? If you pay off the debt, you will have assured instant savings by eliminating the need to come up with the money needed to pay the interest on the debt.
- Would you be able to borrow an additional amount, if needed, and at what interest rate, if you paid off current debt? Do you have an emergency fund, or other source of funds, that could be used if you lose your job or have a medical emergency, or would you have to borrow?
- If your employer matches your contributions in a 401(k) plan, you should generally invest in the 401(k) to get the matching contribution. For example, if your employer matches 50% of your contributions up to 6% in a 401(k) plan, getting the 50% match is like getting an instant 50% return on your contribution. In addition, there are tax advantages to investing in a 401(k) plan.

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What is personal liability insurance and do I have it?

Personal liability insurance protects your assets if you injure another person or damage someone else's property. It's also known as

third-party insurance because it protects you if a third party files a claim against you. Personal liability insurance can be purchased as part of a package policy (such as a homeowners or automobile insurance policy) or as a separate policy (such as a personal umbrella liability policy).

Today, lawsuits are everywhere. What if your dog bites a neighbor? What would happen if someone slips and falls on your front walk? While you may not be able to avoid all accidents, you can transfer some of the financial risk of the resulting loss to an insurance company by buying personal liability insurance.

How much liability coverage do you need? Probably more than you think you do. Because there's no optimum amount that applies to everyone, how much personal liability coverage you need depends partly on your tolerance for risk. Can you afford to pay the cost of a claim out of pocket or would even a small claim

threaten your finances? If you already have liability coverage, take a look at your current policy. Determine whether your liability limits are high enough, or if there are any coverage gaps you'd like to fill.

If you own a homeowners or automobile insurance policy or another type of property insurance (e.g., mobile home insurance or renters insurance), you have basic personal liability coverage. These policies will protect you against many liability claims. Your insurance company will defend or settle claims and lawsuits brought against you and pay the sum owed for covered damages (bodily injury or property damage), up to the liability limits of the policy. If you want greater liability coverage limits or if you want broader coverage that includes more types of claims, consider buying a personal umbrella liability policy.

No personal liability insurance policy will protect you against every loss you might face. Generally, personal liability policies don't cover claims stemming from your business or profession, claims resulting from an act intended to cause injury or damage, and damage to property owned by you.



What is umbrella insurance and why do I need it?

Umbrella liability insurance (ULI) provides additional liability coverage in excess of the liability coverage provided by other insurance policies, such as homeowners, renters, and auto insurance. By providing liability protection above and beyond these basic coverages, ULI can protect you against the catastrophic losses that can occur if you are sued. Although ULI can be purchased as a separate policy, your insurer will require that you have basic liability coverage (i.e., homeowners/renters insurance, auto insurance, or both) before you can purchase an umbrella liability policy.

A typical umbrella liability policy provides protection, up to the coverage limits specified in the policy, for vehicle-related liabilities above your basic auto policy; for claims of bodily injuries or property damage caused by you or members of your household; for incidents that occur on or off your property; for non-business-related personal injury claims, such as slander, libel, wrongful eviction, and false arrest; and for legal defense costs for a covered loss, including lawyers' fees and associated court costs.

Policy exclusions vary from one insurer to another, but typically, basic umbrella liability insurance doesn't cover intentional damage caused by you or a member of your family or household; damages arising out of business or professional pursuits; liability that you accept under the terms of a contract or agreement; liability related to the ownership, maintenance, and use of aircraft, nontraditional watercraft (e.g., jet skis), and most recreational vehicles; damage to property owned, used, or maintained by you; damage covered under a workers' compensation policy; and liability arising as a result of war or insurrection.

How much liability insurance do you need? A large judgment against you could easily wipe out your assets and put your future earnings in jeopardy. That's why you should also consider factors such as how often you have guests in your home, whether you operate a home-based business, how much you drive, whether you have teenage drivers in your home, and whether your lifestyle gives the impression that you have "deep pockets." Your insurance professional can help you determine how much coverage you need.

